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Valassis NSA Docket No. MC2012-14

Valassis NSA Docket No. R2012-8

Public Representative Response to Notice of Inquiry No. 1

(July 2, 2012)

On April 30, 2012, the Postal Service filed a request to add a negotiated service agreement (NSA) with Valassis Direct Mail, Inc. (Valassis) to the market dominant product list.[1] On June 15, 2012, the Commission issued NOI No. 1, and on June 19, 2012 extended the deadline for responses to June 29, 2012.

The Public Representative's general response to this NOI is to observe that the principal rivals in this docket—Valassis and the newspapers—are making essentially the same claims and about market structure and what an adverse Commission decision regarding the proposes Saturation flat mail rebates would do to them. Each asserts that the other has a virtual monopoly over a discreet segment of the Free Standing Insert market (newspapers with a lock on the Weekend FSI market niche, Valassis with a lock on the Midweek FSI market niche). Both assert that if the Commission makes the wrong decision on rebates for Saturation flat mail, they will swallow hard, overlook the inherent disadvantages of using door-hanger companies, and shift the volumes that they plan to distribute in the other's market niche from the Postal Service to door-hanger delivery .

The market for direct marketing messages remains weak due to the economic recession. Therefore, the newspapers and Valassis are both genuine in their assertion that they are highly sensitive to changes in Saturation rates. To a greater or lesser

[1] Notice of the United States Postal Service of Filing of Contract and Supporting Data and Request to Add Valassis Direct Mail, Inc. Negotiated Service Agreement to the Market-Dominant Product List, April 30, 2012 (Notice).

degree, they are probably both genuine in their assertion that in their efforts to stay in (or invade) the other's market niche, the availability or non-availability of the NSA rebates will cause them to shift to door-hanger companies.

The essential difference between the two rivals is that the newspapers assert that they will use the Postal Service to compete on Valassis's home turf (the Midweek FSI market) as long as there are no discriminatory rebates. Valassis, however, asserts that it will use the Postal Service to compete on the newspapers' home turf only if it gets discriminatory rebates. Of overriding importance is the fact that only Valassis is asking the Postal Service to discriminate in its favor so that it can compete on the other's turf. Such a rate preference is clearly and specifically prohibited by 39 U.S.C. 404a(a)(1).

The Public Representative's response to the specific questions of the Notice of Inquiry follow.

1. **Pursuant to 39 U.S.C. 3622(c)(10)(B), the Commission must determine if the Valassis NSA would "cause unreasonable harm to the marketplace." Please identify the relevant marketplace concerning the Valassis NSA. Include a statement of supporting justification.**

"The marketplace" in this instance is direct marketing—the large subset of the advertising sector that is not delivered through mass media. Direct marketing is delivered to the consumer through a plethora of channels. They include unsolicited e-mail, telephone cold calls, in-store coupons, coupons on websites, and coupons mailed at Saturation rates (the RedPlum packets mailed by Valasiss). They include letter-shaped shared mail packets promoting local services mailed at Saturation rates (by Valpak and others). They also include flat- shaped Free Standing Inserts (FSIs) delivered with newspapers, FSIs requested by non-subscribers delivered by newspapers' in-house delivery crews (commonly called Sunday Select) , Midweek FSIs mailed by newspapers at High Density or Saturation rates, Midweek FSIs mailed at

Saturation rates by direct mailers (by Valassis and a handful of smaller comptetitors), and Midweek FSIs hung on doorknobs by alternative delivery crews.

There are so many channels for reaching the consumer with a direct marketing message that the addition or subtraction of one of those avenues will not *directly* affect the economy or the public interest in a significant way, since there are so many readily available alternatives. Creating or destroying those channels in a selective manner however, can have a profound *indirect* effect on the public interest. Targeting the newspaper industry's Weekend FSI program for takeover is a case in point, since it will cripple the newspaper industry financially, and with it, the nation's only robust source of investigative reporting.

The direct marketing channel provided by the Postal Service has a few dominant players and market leaders (such as the Postal Service, Valassis, ValPak, and associated newspapers). Because of the interrelated nature of direct marketing through the Postal Service and private delivery, there are certain subsets of the advertising market that will clearly be impacted by this agreement and other sectors which will be impacted less.

In the United States, the advertising sector as a whole accounted for over $170 Billion in revenue in FY 2011, according to a report by MagnaGlobal.[2] The entire advertising sector is unlikely to be significantly impacted by this NSA. Television advertising and mobile internet advertising are not seen as close substitutes for direct marketing, although there is some substitutability (indeed, television and mail marketing can be complimentary channels).[3] According to MagnaGlobal, direct marketing ad revenue was $42.4 billion in FY 2011 and direct mail ad revenue was $20.5 billion in FY

[2] http://www.cynopsis.com/index.php/download_file/view/2972/

[3] http://books.google.com/books?id=vLP5jFqPg3YC&printsec=frontcover#v=onepage&q&f=false

2011.[4] According to the NAA, print advertising in newspapers was $20.7 billion in FY 2011, 57% of which was from retailers.[5]

The Valassis NSA effectively limits its rebates to one direct marketing aggregator, Valassis, and a sub-component of all advertisers--retailers of durable and semi-durable goods with a physical footprint in at least 30 states. However, in order to understand the marketplace for the content of NSA-qualifying mailpieces, it is vital to look at the market characteristics of the channel that is currently used to deliver this content.

The current market price for placement in a "shared mail" advertising program is a function of multiple layers of competition and what might be called "co-opetition."[6] Retailers and other advertisers can purchase ad space from aggregators such as Valassis, who can mail a shared mail insert package or pay for private delivery of the shared advertising package. Retailers and other advertisers can also hire advertising aggregators such as Valassis to place ads in a shared advertisement package placed in a newspaper insert. These retailers can also purchase space in an advertising package with a newspaper, which can choose to deliver the insert via private carrier as part of the newspaper, or deliver the insert through 3rd party delivery via the Postal Service.[7]

The "shared" nature of these programs has a significant impact on the price. The static price of delivering a shared insert "package" leads to significant economies of

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[4] http://www.dmnews.com/magnaglobal-lowers-2012-ad-forecast/article/214391/

[5] http://www.naa.org/Trends-and-Numbers/Advertising-Expenditures/Annual-All-Categories.aspx

[6] The term "co-opetition" is used to help convey the unusual interdependence of the marketplace for delivering direct marketing messages. A direct marketing agency such as Valassis places ads on behalf of its retail clients with all of the various channel providers (Postal Service, newspapers, website hosts, door-hanger companies, etc.) It also places ads for its retail clients in the distribution channels that it owns, including its Saturation FSI product. From a retail client's point of view, there is an inherent conflict between Valassis's role as full-service advertising agent and its role of advertising channel owner. The newspapers' relationship with Valassis is similarly conflicted.

[7] Retailers and other advertisers can also choose to participate in solo advertising programs using the mail or private delivery options.

scale. The information provided under seal by the NAA makes it clear that certain advertisers act at the “anchor” for shared mail packages, much as department stores act as “anchors” for malls. The presence of an anchor leads to a lower price for other advertisers. Economies of scale and concentrated market power combine to distort competition in the market for Free Standing Inserts (FSI) substantially from what would exist in a pure competition model. Consequently, seismic price reductions that exclusively favor the dominant supplier of FSI (Valassis), such as those incorporated in the this NSA, have the potential to restructure the FSI market. If the competitors of Valassis don’t repond with comparable reductions, they will exit the market, essentially eliminating Valassis’s competitors in that market. If they do respond with comparable reductions, total market profits earned by all participants will shrink dramatically.

The impact of this NSA on the FSI market can be clarified using the following hypothetical:

Company A is a national retailer of durable goods

Company B is a local retailer of durable goods

Company C is a local retailer of consumables.

Currently, Company A distributes its weekly advertisement inserts using newspapers as part of a “Sunday Select” shared-mail package in large urban markets and smaller rural markets. This company pays for 70% of the revenue from this shared mail package at a rate of $70/ per thousand inserts. Companies B and C also distribute their weekly inserts using newspapers “Sunday Select” package at a rate of $15/ per thousand inserts. However Companies B and C also distribute their weekly inserts in the Midweek “TMC” shared mail package for a rate of $15/ per thousand. The “Sunday Select” package is distributed using 100% private carriers, but the “TMC” package is distributed using a mix of private carriers (hired by the newspapers) and USPS delivery (70% of recipients are non-subscribers).

Valassis, using its 36% discount, convinces Company A to begin using the USPS to deliver the weekly insert. The newspaper cannot afford delivery for only Company B and C. Furthermore, Company B and C are not eligible for inclusion in the Valassis mailer. As such, the newspapers and Company B and C agree to switch to weekly delivery instead of bi-weekly delivery of inserts. Furthermore, in order to stay in business, the newspaper must double the rates for Company B and C to $30/ per thousand for Sunday delivery. The Newspaper reduces costs by eliminating postage of the "TMC" package, but advertising revenue declines by 70%. This simplified example highlights the relationship between mailers and mail content owners. To make this simple hypothetical more realistic, one could add the assumption that Companies B and C currently contract with Valassis to design and distribute the inserts to newspapers. In that example, it seems logical that following the departure of the Sunday "anchor," Companies B and C would convert to Valassis delivery as well as design.

The huge, exclusive rate preferences that the Valassis NSA would unleash would lead directly to the capture by Valassis of the Sunday-delivery segment of the FSI market if the newspapers did not match it, or to a dramatic reduction in the profitability of this market for all concerned if they did. Because of this dynamic, the market most directly and seriously impacted is the market for Sunday delivery of free standing inserts (FSI).

As described in the Public Representative's initial comments, the Weekend FSI market is distinct from the Midweek FSI market. The Weekend market has higher read-response rates and brand-protecting properties, owing primarily to the fact that they have been requested by the recipient. As a consequence, the Sunday Select packet typically contains more than triple the number of inserts that the Midweek packet contains. This yields strong scale economies, and much better profits margins than are available from the Midweek packet. This explains the newspapers' reluctance to forfeit the Sunday Select market to Valassis, and Valassis's eagerness to capture it.

Sunday circulation is the last healthy portion of the newspaper business. Its geographic penetration is more than double what it is for circulation during the week. Throughout the newspaper industry, profits from the Sunday Select insert program are indispensable to a typical newspaper's financial survival. The huge rate advantage of the Valassis NSA mail will transfer the newspaper industry's Sunday Select clients to Valassis in the manner described above, or, if the newspapers match those deep discount, the profitability of the market for all participants will plunge. Either way, the structure of the hard-copy direct marketing industry will undergo a seismic shift. As a practical matter, the newspaper industry's participation in that market will end, and the industry will essentially be managed by a vertically-integrated cartel, consisting of Valassis and the Postal Service.[8]

When this capture of the Sunday Select market unfolds, those familiar with the hard-copy direct marketing message market will recognize a familiar pattern. In 2007, when Valassis took over ADVO's shared mail programs, most percent-off coupons were clipped from the pages of newspapers. In 2009, Valassis leveraged its position as all-purpose advertising agent for a large number of retailers by persuading what had been the newspapers' coupon-offering clients to take their coupons out of the newspapers' run of press and transfer them to the Midweek shared-mail packet that Valassis had inherited from ADVO (now the RedPlum packet with which most of us are familiar.)[9] Arguably, Valassis captured the percent-off coupon business from the newspapers by

[8] Expressions by Valassis or the Postal Service that they intend to make only modest inroads into the Weekend FSI market should be taken for what they are—unenforceable expressions of benign intent that are not backed up by any concrete restrictions in the NSA itself.

[9] After Valassis converted Red Plum from a Sunday newspaper insert to its own Midweek shared-mail packet, Valassis's then-marketing director (now CEO) Robert Mason was asked by a stock analyst in a February 2012 investor conference how the conversion was playing out. He answered that it had taken a full two years for the coupon redemption rate to recover to the level that it had prevailed when the coupons ran in the newspapers. This demonstrates that the ROI, and therefore the demand, for the Midweek shared mail product is inferior to that for Weekend FSI market. Advertisers' memories of the difficulties encountered by that conversion go a long way toward explaining why the massive rebates built into the Valassis NSA would be needed to persuade advertisers to leave Sunday Select for the Midweek shared mail product.

seizing the initiative on a level playing field. If it captures the Sunday Select segment of the FSI market from the newspapers, however, it will have been because it persuaded a government monopolist to rearrange the playing field in its favor.

For the reasons described above, the market that would be most disrupted by the Valassis NSA is the Weekend segment of the FSI delivery market.[10] However, the relevant market includes the Midweek FSI market because there is significant durable good advertising in that market for a minority of newspapers. It is also clear that the market for door-hanger delivery of FSI will be impacted. The newspaper industry already uses that channel for 40 percent of its TMC program and asserts, credibly, that its usage will increase by some 30 percent if the Valassis rebates for Weekend FSI are adopted. Valassis itself asserts that it is on the verge of shifting its FSI delivery to the door-hanger channel if discriminatory rebates aren't approved.

Finally, solo Standard mail also belongs in the relevant market that the NSA would disrupt. The Postal Service describes the NSA as though it reliably excludes what was solo direct mail mailed on behalf of Valassis's former durable goods retailer-clients. The provenance of solo direct mail, however, is difficult to trace, as previous promotional rates for Standard mail have proven. Therefore, there is little basis for assuming that full-price solo mail previously placed through Valassis will be effectively prevented from shifting into heavily discounted NSA mail. Further, the NSA does not bar solo direct mail that a durable goods advertiser had placed with other direct mail agency providers. Thus, there is no pretense that that source of full-price mail will not shift to heavily discounted NSA mail. Consequently, significant volumes of full-price

[10] The Valassis NSA with its deep rebates would essentially destroy the profitability of that distribution channel by its third year of operation. Therefore, these huge rebates make financial sense for the Postal Service if they are treated as temporary promotional rates, and are abandoned in favor of full-price Saturation rates after the three-year life of the FSA. They only make sense for Valassis if its Weekend FSI program is the only one left standing after three years, and for that reason would be viable at non-discounted Saturation rates.

solo direct mail can be expected to shift into the heavily-discounted Saturation mail product that Valassis would control. The resulting concentration of market power in the hands of Valassis would disrupt the entire $20 billion market for hard-copy direct marketing message delivery. This would clearly benefit Valassis because it could pocket a healthy percentage of the postage cost reduction. This disruption of the direct mail marketplace, however, would reduce profit margins for the Postal Service's portion of the general market for direct mail, and with it reduce the profitability of direct mail generally for the Postal Service.

2. **To assist the Commission in determining the Valassis NSA's financial impact on the Postal Service as required by 39 U.S.C. 3622(c)(10)(A)(i):**

   a. **Please provide a quantitative analysis of the expected loss in contribution Valassis primarily attributable to the Valassis NSA (in pieces and postage pounds), including lost revenues from mailers that are not a party to the agreement. Please include all supporting workpapers.**

Evaluating the impact of this proposal on the Postal Service is a difficult task because of mail ownership issues. The Postal Service's coalition of Mail Service Providers and FSI content aggregators is not built for visibility into the contents of a shared mail program. Past Incentive Programs (e.g. the 2010 summer sale) have also demonstrated how difficult it is to gather information regarding historical postal volumes of a large set of mailers. The Postal Service has not allowed the Commission to provide any transparency (either through a public document or under seal) regarding the mailers are that will use this agreement. Due to this, the Commission's accepted methodology for analyzing NSAs cannot be utilized because there is no information regarding the historical usage of the mail by these advertisers.

Furthermore, as explained in response to question 1 of this NOI, the downstream and upstream impact to mailers not party to the agreement will be significant. While there is little transparency as to how this agreement will operate, there can still be some meaningful economic analysis as to the impact of this agreement on the bottom line of the Postal Service, provided certain disputed assertions are taken as fact.

- First, one must take the Postal Service's argument that the retailers who are eligible to participate in this NSA do not currently use the mail for insert distribution as fact.
- Second, one must take the NAA's argument that there is $600 million in TMC packages delivered via the USPS per year as fact.
- Third, one must assume that the "Sunday Select" insert is delivered to the target population of 46,850,000 each week[11] and each of these inserts contain advertising eligible for the Valassis NSA.
- Fourth, one must assume that private delivery costs roughly half that of Postal Delivery.[12] The cost of private delivery versus postal delivery for geographically target advertising will be further explored in response to question 8 of this NOI.

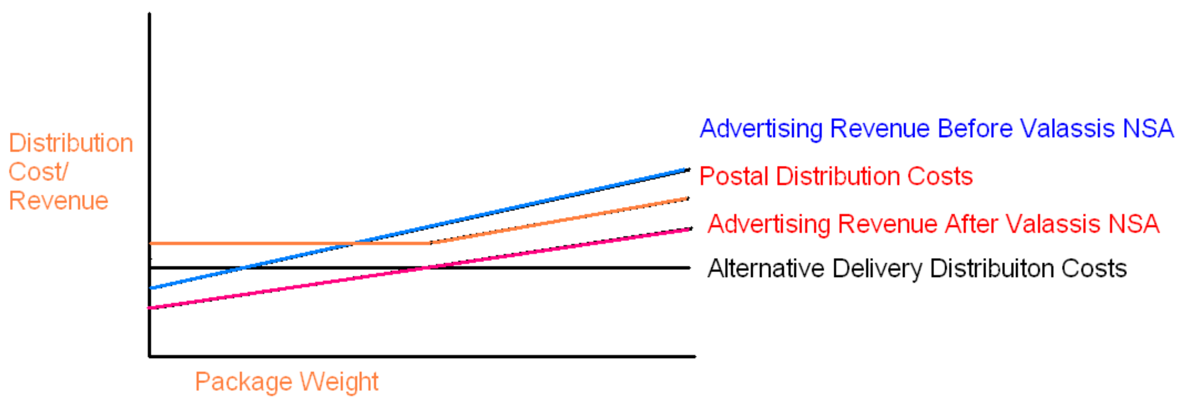
Given these assumptions, the financial impact on the Postal Service can be understood.

The most obvious financial impact will be on the aggregators that are currently engaged in co-opetition with Valassis. Because Valassis mails shared FSI packages, privately delivers shared FSI packages, and contracts with newpapers to deliver shared

[11] The 2009 circulation volume for NAA members. This is likely to understate the circulation of the "Sunday Select" advertising insert, as the insert is also delivered to non-subscribers. See http://www.naa.org/Trends-and-Numbers/Circulation/Newspaper-Circulation-Volume.aspx

[12] http://www.adsmediagroup.com/images/Direct_Mail_vs_Door_Hangers.pdf

FSI packages, this NSA will give Valassis considerable leverage over its competitors and distributors. The advertising revenue generated by Valassis for newspapers will certainly decline, even if Valassis never sends a piece pursuant to the NSA. The following chart shows how a reduction in advertising revenues could lead newspapers to shift some or all TMC delivery to alternate channels. At current advertising revenues, the newspapers are able to afford Postal Distribution. As the advertising revenue declines, the ability of newspapers to pay for postal distribution decreases. The Advertising curves are analogous to supply curves, and the delivery distribution costs are analogous to demand curves. Faced with a inward shift of the supply curve, the content distributor may be forced to shift to a cheaper and lower quality distribution channel to stay above marginal cost.



Due to a reduction in advertising revenue, it is reasonable for newspapers to decrease their postage expenditure.

Thus, there are 3 potential financial outcomes from the Valassis NSA:

1. Valassis is unable to convince eligible retailers to use the NSA, and no volume is mailed at NSA rates. Valassis is, however, able to convince retailers to use Valassis to place FSI content in newspaper shared FSI package. The decrease in advertising revenues lead the Newspapers to reduce their mail volume. Postal Service revenue would decline in lock step with the reduction in newspaper

advertising revenue. Given the Valassis discounts range from 22-36%, it is reasonable to assume that the NSA-eligible retailers could push for a 15% reduction in distribution costs from newspapers. A 15% reduction out of $600 million in TMC postage would lead to $90 million in lost revenue for the Postal Service.

2. Valassis is able to convince 4 to 8 eligible retailers to use the NSA, and the NSA volume precisely meets the “high estimate” expectations of the Postal Service. Assuming that all of the mail is new to the Postal Service, the new mail accounts for $107 million in revenue and $15 million to the Postal Service in contribution. The newspapers are faced with a reduction of at least $107 million in advertising revenue. However, not all of the FSI content has been removed from the “Sunday Select” package the newspapers continue to distribute papers and advertising. With regards to postage, the newspapers respond to the change in the supply curve change by reducing TMC distribution through the Postal Service by over $107 million in revenue, or nearly $50 million in contribution. Under this scenario, the net financial result to the Postal Service will be negative $35 million.

3. Valassis is able to convince enough retailers to use the NSA that it is able to take advantage of the best rate in the NSA, and send 11.9 ounce Saturation flats that it enters at the DDU for 21.1 cents per piece. Many Sunday Select inserts are less than 12 ounces, so in this scenario Valassis replaces the Newspaper industry as the major distributor of FSI content. If Valassis mails to the 46,850,000 households that currently receive the “Sunday select” inserts 52 times a week for three years, Valassis would increase its volume by 7.2 billion pieces. This amounts to $1.5 billion in revenue for the Postal Service. This mail

would account for contribution between \$600 million and \$800 million, depending on the cost of delivering additional ounces of Saturation Flats.[13]

Under this scenario, the newspapers would no longer be in the business of distributing FSI content. As such, the Postal Service would lose \$600 million per year, or \$1.8 billion in HD and Saturation "TMC" Mail. Because this mail currently has cost coverage of over 200 percent, the lost contribution would be roughly \$900 million. With both the additional volume from Valassis and the reduced volume from newspapers counted, the Postal Service would likely lose between \$100 and \$300 million in contribution per year.

Because Valassis, the Newspapers, and the Postal Service are engaged in co-opetition for FSI content production and distribution, the mechanics of preferential pricing for one party are particularly difficult. As stated by Dr. Panzar in the Capital One NSA:

> [W]hen user demands are independent, any optional tariff offering voluntarily agreed to by a user and a profit-seeking monopolist can be presumed to be efficient because it can make possible a Pareto improvement. No such presumption is possible when there are downstream competitors of the favored user. The elegant, simple argument of the previous section breaks down because the output expansion of the favored user will be (to some extent) offset by an output contraction of users that do not avail themselves of the discount. A foresighted monopolist would of course take such feedback effects into account when designing an optional tariff offering, ensuring that it would be attractive to the (foresighted) large user and profitable if taken up. However, the negative effect on small users will remain, even if the establish[ed] tariff remains available. Docket No. MC2002, Tr. 15/1591-92

[13] The Postal Service does not have cost information by weight category for Saturation flats. The Postal Service does not calculate the cost or contribution difference between a 4 ounce saturation flat as compared to a 12 ounce saturation flat in the Valassis NSA workpapers (or on the record in this docket). The average cost of a saturation flat is 7.1 cents. The Postal Service charges 35.7 cents per pound of DDU entered Saturation Flat, with a flat charge of 7.1 cents per pound rated piece. The Postal Service calculates additional ounces as "pure" contribution. This seems like an unlikely stretch, given the price per pound.

The Postal Service is caught in a veritable catch-22. The Valassis NSA aims to convert Newspaper advertisers to mail their shared FSI packages. If Valassis can convert some advertisers without causing the Newspapers to decrease usage of the mail for the "TMC" product, then the Newspapers are captive, price inelastic, users of a market dominant mail product. If this occurs, the Postal Service would benefit at the expense of a captive user of the mail. Such an example is exactly why the PAEA includes discriminatory protections in the Negotiated Service Agreement language. If the Newspapers are elastic postal customers, then there is no way that the Postal Service can gain enough volume from Valassis to offset the lost revenue from Newspapers over the life of the contract.

3. **In its Notice, the Postal Service states "[s]aturation mailers are increasingly looking to private delivery options, and newspapers are extending their reach through Total Market Coverage and Sunday Select (distribution to non-subscribers) delivered via nonpostal carriers." Notice at 3. Please provide any available data on the diversion of advertisement circulars that were historically delivered by the Postal Service that are now delivered by private (nonpostal) carriers.**

The diversion of Total Market Coverage (the newspapers' Midweek FSI program) to door-hanger delivery has been substantial over the last five years. In 2006, it was roughly 10% of the TMC program. By 2011, the share of the TMC program using the door-hanger delivery channel had grown to 40%. There is considerable contention over the cause of this shift, with Valassis and the Postal Service suggesting that is a public relations ploy or political conspiracy, etc. However, there should be little dispute about the cause of this shift when one examines the growth in the direct mailers' rate advantage over the newspaper industry in over the past five years.

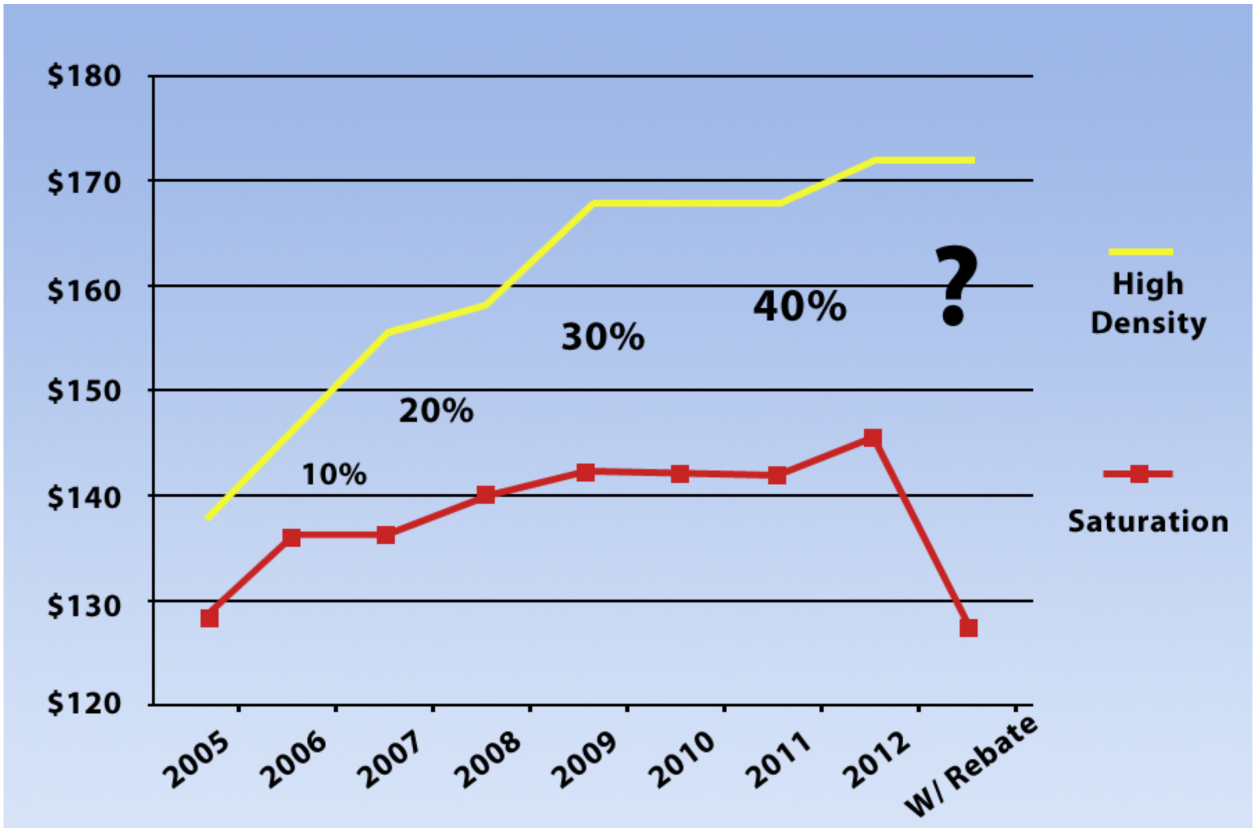
The table below shows that in 2006, the rate gap between High Density mail (the service that newspapers TMC program typically uses) and Saturation mail (the service that Valassis's FSI program typically uses) was $9 per thousand.[14] By 2012, this gap had tripled to $27 per thousand.[15] Over that same period, the newspapers' use of door-hanger delivery a little more than tripled, growing from roughly 10% to 40%.

The near parallel between the two trends is no accident. High Density and Saturation mail are operationally the same service. If the postal carrier checks each Saturation piece against the "Do Not Mail" list as his is obligated to do, he has to look at each piece of Saturation mail to determine if it should be selectively delivered just as he is obligated to look at each piece of High Density mail to determine to whom it should be delivered. From the consumer's point of view there is no difference either. Because of the almost perfect substitutability of the two service's, the rate differential drives the advertising agent's decision as to which service he prefers to use. As a practical matter, the only way for newspapers to overcome the rapid increase in the rate advantage enjoyed by Valassis has been to increase the industry's use of the cheaper services of door-hanger delivery companies.

[14] $136 per thousand vs. $145 per thousand.

[15] $145 per thousand vs. $172 per thousand.

POSTAGE RATE TRENDS AND SHIFT TO ALTERNATE DELIVERY



4. **Please explain the availability and nature of enterprises in the private sector engaged in the delivery of advertisements for firms that sell or distribute semi-durable and durable goods nationally. *See* 39 U.S.C. 3642(b)(3)(A).**

The channels that are available for delivering FSIs for durable and semi-durable goods retailers are the same as the channels that are available for delivering FSIs for non-durable goods retailers—the Postal Service, in-house newspaper delivery crews, and door-hanger companies.

From the point of view of durable goods retailers, door-hanger delivery suffers several inherent disadvantages relative to the other two delivery channels. The geographic footprint of door hanger companies is spotty. Some large metropolitan areas have an established door hanger company that delivers reliably and can discriminate between subzones, and even carrier routes. These, however, are the exception rather than the rule. Most door hanger companies rely on a part-time, minimum-wage workforce characterized by rapid turnover. As a result, reliability and consistency of delivery is difficult to come by. Typically it costs $70 per thousand to contract with a door hanger company, which is half what delivering FSIs via Saturation mail would cost. When the indirect cost of verifying delivery (typically about $50 per thousand) is added, however, the cost advantage of contracting with door hanger companies is greatly reduced. For in-house newspaper carriers, verifying delivery is much less of an issue because the piece delivered has been requested by the recipient, and the typical recipient will promptly lodge a complaint with the newspaper if there is a delivery failure. Delivery is highly reliable if an FSI product is delivered through the mail.

Another inherent disadvantage of contracting with door hanger companies besides unreliable delivery and limited ability to discriminate between portions of zones, is the fact that delivery to the driveway or doorknob results in lower read and response rates than delivery through Saturation mail. Saturation read and response rates, in turn, are low relative to Weekend FSI programs of newspapers which are typically limited to subscribers and to non-subscriber requesters.

From the point of view of durable goods retailers, both door-hanger delivery and delivery by newspaper carrier have an advantage over Saturation mail as a channel for FSI packets because there is both a piece charge and an ounce charge for Saturation mail. This makes it less economical for a durable goods circular to be combined with the circulars from other advertisers into a heavy Saturation flat mail packet. As far as national-brand durable goods retailers are concerned, relatively high read and response rates, and the ability to carry heavy FSI packets without added cost, are advantages that are inherent in the Weekend FSI delivery programs of newspapers. Although newspaper circulation has been declining rather rapidly over the last five years, circulation of Sunday newspapers, and the Weekend FSIs that accompany them, have held almost steady over that time.

Saturation flat mailers have an advantage over other channels that compete to distribute FSIs for durable goods retailers in that the market for shared Saturation flat mail is overwhelmingly dominated by a single mailer—Valassis. Valassis is a full-service advertising agent for retailers. It places ads on behalf of client-retailers with all of the various channel providers (Postal Service, newspapers, website hosts, door-hanger companies, etc.)

In that role, it gains access to the precise rate structures and market penetration posture of those channel providers. This includes the detailed rates that newspapers would charge Valassis's client retailers and what ZIP Codes and carrier routes they deliver to. Valassis then uses this information to surgically undercut the prices that newspapers charge advertisers, luring them to use one or more of the channels that Valassis itself owns. This includes Valassis's Midweek FSI program. If the NSA rebates are approved, Valassis will have enormous leeway to undercut the newspaper's prices for Weekend FSIs, with the advantage of knowing precisely how much a price reduction will be required in exactly what ZIP codes, to capture the durable goods retailer's FSI business from the newspapers. Because the anti-trust laws bar newspapers from sharing detailed advertising rate information, the newspaper industry cannot respond in kind by setting up its own vertically-integrated ad agency/channel provider.[16]

5. **Please provide information regarding the views of those who sell or distribute semi-durable and durable goods nationally, and/or those who sell or distribute advertising for firms that sell or distribute semi-durable and durable goods nationally on the appropriateness of the Valassis NSA. *See* 39 U.S.C. 3642(b)(3)(B).**

This question is not directly addressed to the Public Representative. Logically, however, if a durable goods retailer is one of the select few with a brick and mortar footprint in 30 states, and who would otherwise qualify for the rebate that this NSA would offer exclusively to Valassis, it would be pleased to have the option to mail FSIs at deep discounts. All others would be feeling unfairly discriminated against, and worried about their ability to effectively advertise on a playing field that will have suddenly become tilted against them.

As far as the channels that distribute FSIs for the largest national brand durable goods retailers, this NSA will please Valassis. It will dismay all other full-service direct marketing agencies that compete with Valassis for the FSI business of those elite retailers. The interests of Valassis's indirect competitiors (newspapers and door-hanger companies) have been articulated reasonably well in this docket.

The interests of Valassis's direct competitors, such as Vertis and LatinPak, who are not eligible for the enormous rebates that this NSA would make available to Valassis, have been drowned out by the high-decibel debate

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[16] This means that if newspapers were to become eligible for the rebates proposed in this NSA, they could not use them to lure advertisers away from Valassis anywhere near as effectively as Valassis could use them to lure advertisers away from the newspapers.

between Valassis and the Postal Service on one side, and the newspaper industry other.

It is the direct competitor of Valassis, however, that will clearly not be able to withstand the enormous price advantage that Valassis would be able to offer national brand durable goods advertisers. By virtue of this NSA, the Postal Service will choose Valassis as the winner in the marketplace for Saturation shared flat mail advertising for qualifying retailers, while it chooses Vertis, LatinPak, and Valassis's other direct competitors as the losers of this business. This tilting of the playing field against Valassis's direct competitors is clear, undisputable, and fatal. It is as plain as the nose on the Public Representative's face that it will cause "unreasonable harm" to this marketplace. If this NSA is approved, Valassis's direct competitors will have absolutely no chance whatever to solicit or retain the largest national brand durable goods retailers as their clients. This is as clear a violation of 39 U.S.C. 3622(c)(10)(B) as one can imagine.

6. **For purposes of this question, a small business concern is one that is in conformance with the requirements of section 3 of the Small Business Act. *See* 39 U.S.C. 3641(h).**

   a. **If your organization qualifies as a small business under the Small Business Act, please indicate whether your organization sells or distributes semi-durable and durable goods nationally or sells or distributes advertising for firms that sell or distribute semi-durable and durable goods nationally.**

   b. **Please provide specific examples of small business concerns likely to be impacted by the Valassis NSA, and discuss how representative**

those examples are of other small business likely to be impacted by the Valassis NSA. *See* 39 U.S.C 3642(b)(3)(C).

This question is not directed to the Public Representative. The Public Representative refers the Commission to the comments of Valassis's smaller direct competitors, such as Vertis, and LatinPak.

7. **Please discuss the meaning of a "similarly situated mailer" under 39 U.S.C. 3622(c)(10) as it relates to the Valassis NSA.**

A similarly situated mailer clearly would have to include Valassis's direct competitors. These are direct marketing companies that offer the full spectrum of electronic and hard copy distribution channels for direct marketing messages, including shared-mail Saturation flats. If they have the ability to distribute shared-mail Saturation flats on a national level as part of a coordinated direct marketing campaign, they are "similarly situated."

In view of the objectives of this NSA, neither the requirement that a direct marketing company already be mailing above 400,000,000 pieces annually, or the requirement that it have a geographic footprint in half of all SCF service areas, is a meaningful qualifying characteristic. All that is relevant is the ability of a direct mail company to coordinate the printing and entry of the FSIs on a national level and the ability to target delivery to discreet ZIP Codes and carrier routes. There are a number of direct marketing companies with this capability, including Vertis, LatinPak, and, presumably, Harte Hanks. Some of the larger newspaper publishing chains have similar expertise and capability, and would "similarly situated" as well. [17]

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[17] It should be noted that if shear volume and size of geographic footprint were legitimate requirements to be eligible for the rebates that this NSA involves,, the NSA would not allow Valassis to launch this NSA by initiating a program in a single ZIP Code.

8. **Please discuss whether each of these currently market-dominant subproducts would qualify as a competitive product under 39 U.S.C. 3642(b)(1).**

   a. **Saturation Flats.**

   b. **Saturation Parcels.**

   c. **High Density Flats.**

   d. **High Density Parcels.**

The market for Saturation flats is subject to competitive pressure from door-hanger companies and from newspapers. The Postal Service, however, retains substantial market power over the market for the delivery of Saturation flats. This is demonstrated by the fact that alternative delivery companies typically have to charge a 50 percent discount under Saturation rates ($70 per thousand vs $140 per thousand) in order to attract a share of this market. The reasons that the Postal Service can command nearly double the price that alternative delivery companies can command is that it provides delivery in the mailbox, which is barred to alternative delivery carriers. This enhances the read and response rate relative to messages left on driveways or hung on doorknobs.

The reliability of delivery is very uneven for door hanger companies, owing to the low wages paid its delivery staff and the resulting high rate of turnover. In contrast, the Postal Service has a professional delivery staff and highly reliable delivery. Newspapers' in-house delivery operations compete with Saturation flat mail, but only in certain contexts, where the market penetration of newspapers is high enough to make it economical for in-house delivery. Outside of the Sunday edition, newspapers generally concede the market for delivery direct marketing messages to Saturation mail.

Respectfully Submitted,
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Docket No. N2012-1
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