Postal Regulatory Commission
Submitted 8/28/2012 12:59:17 PM
Filing ID: 85039
Accepted 8/28/2012

Valassis NSA Docket No. MC2012-14

Valassis NSA Docket No. R2012-8

Public Representative Response to Order No. 1450

(August 28, 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. On August 23, 2012, the Commission issued Order No. 1448.[1] On August 24, 2012 the NAA filed a Motion to Stay the Commission's Order pending review in Appellate court.[2] On August 27, 2012 the Commission shortened the deadline for responses to the Motion to Stay to 1 PM on August 28, 2012. The Public Representative respectfully requests the Commission consider the following comments.

The Commission's Opinion in this docket borrows principles of the antitrust field, but it misapplies them in an arbitrary, result-oriented way. The Commission's Opinion contains an economic concept and applies it in a way that no reasonable observer could anticipate. Too little opportunity was afforded in this informal rulemaking to examine which precepts and principles of the antitrust laws are relevant and should guide the Commission in evaluating the issues that this NSA presents, and which are not. A court remand to adequately evaluate these issues is sorely needed. Meanwhile, much damage could be done to the industry that is impacted by this NSA if the Commission's decision is not stayed.

The Commission's Opinion takes a deeply discounted rate offered by a de jure monopolist (the Postal Service) to a de facto monopolist (Valassis) that none of the de

---

[1] Order No. 1448 Approving Addition of Valassis Direct Mail, Inc. NSA to the Market Dominant Product List, August 23, 2012.

[2] Newspaper Associated of America Motion for Stay, August 24, 2012.

facto monopolist's competitors can access, and pronounces the discriminatory rate to constitute "fair competition" by virtue of the fact that the discriminatory rate covers its marginal cost.

The simple fact is that with the Valassis NSA contract in its pocket, Valassis can shop around to approximately half of all the biggest durable goods retailers in the country Free Standing Insert (FSI) delivery for $20 dollars per thousand, compared to $45 per thousand that it will cost the retailer to have a newspaper in the same town deliver the FSI. It can now go through the entire Fall selling season locking up the business of national durable goods retailers in the top 100 markets in the country with three-year contracts. With this price advantage, it can obviously force the newspaper industry to give back almost all of the profit that it now makes on weekend FSI delivery, just to keep customers. Local and regional newspapers, a large percentage of whom are on the brink of (if not in) bankruptcy, will drop like flies.

The Commission's Opinion characterizes this result as the proper workings of "fair competition." Because Mail Classification cases are not litigated with on the record hearings, and the evidentiary record is not built with verifiable information subject to rebuttal testimony, the Commission has not had the opportunity to fully examine the market structure for FSIs, especially information regarding the market power of the dominant firm-- Valassis. Omitted from the information available for the Commission analysis is the fact that Valassis is now a market force in the weekend FSI delivery market that it never was before only because it has been given exclusive access to a deeply discounted rate from its supplier. The wonder of the Valassis NSA is that Valassis can shop FSI delivery, under certain circumstances, for less than half of what a viable price from the newspaper industry would be and *still maintain its profit margins.* Meanwhile, the profit margin that the Postal Service will get from qualifying pieces of Saturation Mail is cut by almost 70 percent (from 9 cents a piece to 3 cents a piece) and Valassis's newspaper competitor's profit margin is cut by almost 70 percent as well.

How did Valassis pull off this financial miracle for its shareholders? It would reflect the proper workings of "fair competition" if Valassis could offer this devastatingly deep discount because it had lowered its own printing and production costs by this percentage, or decided to voluntarily reduce its own profit margin by almost 70 percent. But neither of these examples of the proper workings of "fair competition" is to blame. Valassis can pull off this financial miracle at the expense of both the Postal Service and the Newspaper's existing profit margins for one reason and one reason only—its monopolist supplier has agreed to anoint it as the sole beneficiary of price discrimination.

To exonerate the price discrimination that is enshrined in the Valassis NSA as "fair competition" the Commission's opinion relies almost entirely on principles borrowed from the field of antitrust law. This conclusion purports to be based on principles borrowed from the field of antitrust law. The trouble is, the Commission invokes the antitrust principles that are not relevant to this agreement, and ignores the ones that are.

In the United States, antitrust safeguards take two basic forms—structural prohibitions and behavioral prohibitions. The structural prohibitions are found in the Sections 1 and 2 of the Sherman Act (that bar the intentional formation or active maintenance of a monopoly) and section 7 of the Clayton Act (which prohibits mergers whose effect is to lessen competition). With respect to structural prohibitions, the first step in the analysis is to determine the "relevant market." This is a term of art that defines a market in terms of the market power--present and potential--possessed by an alleged monopolist. The purpose of identifying the "relevant market" is to measure the degree of market concentration as one indicator of the power of a monopolist supplier over the prices charged or quantity sold in that market. The focus of "relevant market" analysis is the potential impact on the consumer of prices that are higher, or quantities that are lower than they would be under effective competition.

Behavioral prohibitions are found in the rest of the Clayton Act, and in the Robinson-Patman Act. They do not focus on defining monopoly power and, if the definition is met, dismantling it so that market forces can operate freely. Instead, they focus on heading off incipient anticompetitive behavior by prohibiting certain categories of conduct--such as discriminatory pricing that "substantially lessens competition," tying arrangements, and exclusive dealing agreements-- before that behavior causes damage. With respect to behavioral prohibitions, violations are found on the basis of anticompetitive harm to the *sellers* of a product as well as its ultimate consumers.[3]

It is the behavioral prohibitions, not the structural prohibitions of the antitrust laws that are relevant to section 3622(c)(10) (B). Section 3622(c)(10)(B) does not use the term of art "relevant market." It uses the generic term "marketplace" and speaks of "unreasonable harm" to it. Section 3622(c)(10)(B), therefore, deals with the same subject matter, and uses almost the same terminology, as the Clayton Act. The Commission's exclusive focus on the impact of the Valassis NSA on the immediate consumers of FSIs (durable goods retailers) to the exclusion of the providers of FSI delivery is not grounded in relevant antitrust law. Therefore, pronouncements by courts that the purpose of that Sherman Act is to "protect competition, not the competitor" do not transfer to the behavioral prohibitions of the Clayton and Robinson-Patman Acts. Those Acts can be violated if the consumer is harmed indirectly, *through harm to the number and diversity of resellers.*

The obvious potential harm to consumers of FSI delivery (such as durable goods retailers) if an FSI distribution channel (such as a local or regional newspaper) is

---

[3] The phrase "the marketplace" in section 3622(c)(10)(B) is generic, and therefore broad enough to encompass both resellers and consumers. If the prices charged to the resellers of a product are discriminatory, this constitutes "second line" price discrimination under the Robinson-Patman Act. The prohibition of second-line price discrimination reflects the principle that if price discrimination against resellers reduces the number and diversity of distribution channels for a product, it ultimately harms the consumer. The Robinson-Patman Act , by its terms, applies to "commodities" rather than services, but courts have found newspaper advertisements to be a commoditized hybrid product. See Sun Communications v. Waters Publications, 466 F.Supp 387, 391 (W.D., Mo) 1979. FSIs, therefore, are likely to be viewed as a commoditized hybrid product as well.

destroyed is blithely ignored by the Commission. The Public Representative does not maintain that section 3622(c)(10)(B) should be governed by analogies to the antitrust laws, because those laws weren't intended to address the issue of how a legal monopoly like the Postal Service might harmlessly engage in price discrimination. But if the Commission is to rely on antitrust principles as its guide in resolving that issue, it should rely on the principles that are relevant (those that apply to behavioral prohibitions) rather than the ones that are not (those that apply to structural prohibitions).

The most important failing of the Commission's analysis, and one that the D.C. Circuit Court is sure to notice, is step in the analysis that concludes that price discrimination is "fair competition" as long as the discriminatory price is above marginal cost. This is an utter misuse of the concept of pricing above marginal cost. For a multi-product firm like the Postal Service, pricing a product of above its marginal cost is a test of cross-subsidy of one product by another. In the antitrust field that deals with structural prohibitions, pricing a product below its marginal cost is a *per se* violation of the antitrust laws. But nowhere in the antitrust laws does the mere fact that a monopolized product (like Saturation Mail) is priced above its marginal cost provide a "safe harbor" that removes a blatantly discriminatory price for a monopolized product from further scrutiny for its anticompetitive effects.

The mistaken assumption that pricing above marginal cost functions as a "safe harbor" under antitrust principles is central to the Commission's Opinion. It badly misrepresents the state of the antitrust laws. If allowed to stand, this opinion will render all future NSA discounts immune from review, as long as they are above marginal cost. If Congress intended this result, it would not have enacted section 3622(c)(10)(B), since there is already a requirement in 3622(c)(3)^ that all classes of mail (including special classifications like NSAs) recover their marginal costs. A flaw in legal reasoning of this magnitude means that NAA's appeal to the D.C. Circuit is likely to succeed on the merits.

It is more than ironic that the Commission's opinion is written in such a way as to imply that one of the foremost authorities in the field of regulatory economics, Dr. John Panzar, agrees with the Commission's assertion that if a monopolized product is priced above its marginal cost, it can, by that fact alone, be pronounced "fair" and has reached a safe harbor where no further inquiry into possible downstream anticompetitive effects is warranted. Here is what Dr. Panzar actually said on this point:

> [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 [or cannot] avail themselves of the discount. Docket No. MC2002, Tr. 15/1591-92 (emphasis supplied).

Newspapers are the downstream competitors of the favored user (Valassis). It is their "output contraction" that Dr. Panzar and the newspapers both warn will ensure. The contraction, they say, will be potentially severe. As a consequence, the number and diversity of channels for distributing weekend FSIs will disappear, one local market at a time. The Commission's Opinion blesses this result as the price that must be paid to allow normal market forces to do their destructive work. It is, in fact, the price that will be paid because the Commission is allowing one monopolist to hand price leverage to another to jointly take over a market (the weekend delivery of FSIs) that they could not crack any other way.

The Commission's Opinion spends most of its analytical time defining the "relevant market" through the use of the hypothesized monopolist test to see if such a monopolist could sustain a premium price for a particular product in a particular geographic market. The irony is that after explaining the test, it didn't use it. If had actually used the test, it would have found that a hypothetical monopolist with total control of mailbox delivery in a particular city would be able to sustain a price almost double that of private "door hanger" delivery for the midweek FSI packet market. It would also have found that a monopolist with total control over the delivery of weekend FSI packets inside a newspaper in a particular city would be able to sustain a premium price over unaccompanied mailbox delivery, particularly with brand conscious advertisers. The size of the premium varies according to the city and the newspaper.

This means that the market that is relevant for purposes of determining potential competitive harm is much narrower than the Commission's opinion concludes. It is the weekend delivery of FSI packets inside newspapers that is the market that is relevant for purposes of evaluating competitive harm. Newspapers have an inherent advantage in this market, because brand-conscious durable goods retailers know that their FSI is accompanying a publication that the recipient actually requested, and will have the leisure time that is available on a weekend to spend examining both the publication and the FSI. It is this inherent advantage that necessitates discounts of up to 30 percent if Valassis is to overcome it. It is this FSI distribution channel that can be damaged potentially beyond repair, one town at a time, if the Valassis discount is widely and aggressively marketed before any "similarly situated" discount that might be made available to the newspaper under siege can be approved and implemented.

The Reply Comments of the Public Representative in this docket discusses an additional reason that the Commission should stay its ruling pending further review. As explained on pages 4 to 5 of the Reply Comments, Valassis wears two strategically beneficial hats. It is both a mailer of FSIs on its own behalf (of the Red Plum coupon book), and a broker/consultant specializing in placing FSIs in newspapers throughout the country. It will now have the unique advantage of being the only FSI producer with access to discounted Saturation Mail rates. Thus, Valassis can use the NSA rates to entice advertisers to use Valassis for both FSI production and newspaper placement services. With the leverage of Saturation Mail delivery at deeply discounted rates, Valassis will be able to negotiate lower rates for its clients for newspaper placement, whether or not it sends mails any Saturation Mail at the NSA rates on its own behalf.

Valassis, acting as direct mailer, will not benefit until enough mail has been sent to qualify for the lower rates. The Postal Service, similarly, will not benefit [if at all] until mail is actually sent pursuant to the agreement. Valassis, operating as broker, will benefit immediately from the agreement if it is not stayed pending further review. Valassis will be able to use the NSA rates as leverage to negotiate lower rates with newspapers before mailing any volumes at the NSA rates.

The ongoing uncertainty regarding the legality of the agreement argues in favor of the Commission granting a stay. Valassis's broker activity will have the ability to alter the market for FSIs while appellate courts review the agreement. The harm will be immediate, unlike the benefit to the Postal Service. Furthermore, advertisers and newspapers will face considerable uncertainty regarding the future market for FSIs. In 2011, the Commission granted the Postal Service's request for a Stay of the 2010 ACD remedial actions. In Order No. 739, the Commission ruled to stay its findings to prevent uncertainty regarding the market for Standard Mail Flats. The present issue is similar. If the Commission does not stay Order No. 1448, advertisers will face substantial uncertainty regarding future FSI delivery costs, which will chill activity in this line of commerce to the detriment of both qualifying advertisers, the newspapers, and the Postal Service itself.

Respectfully Submitted,
/s/ Malin Moench
Public Representative for
Docket No. N2012-1
JP Klingenberg
PR Technical Analyst

901 New York Ave, N.W. STE 200
Washington, DC 20268-0001
202-789-6823
Malin.Moench@prc.gov