

BEFORE THE
POSTAL REGULATORY COMMISSION
WASHINGTON, DC 20268-0001

Market Dominant Product Prices)	Docket No. MC2014-21
Standard Mail)	
PHI Acquisitions, Inc.)	
)	
Market Dominant Product Prices)	Docket No. R2014-6
PHI Acquisitions, Inc. (MC2014-21))	
Negotiated Service Agreement)	

**VALPAK DIRECT MARKETING SYSTEMS, INC. AND
VALPAK DEALERS' ASSOCIATION, INC.
INITIAL COMMENTS ON PHI ACQUISITIONS, INC.
NEGOTIATED SERVICE AGREEMENT
(March 27, 2014)**

On March 5, 2014, the Postal Service submitted a Notice of Filing of Contract and Supporting Data and Request to Add PHI Acquisitions, Inc. Negotiated Service Agreement ("PHI NSA") to the Market-Dominant Product List (hereinafter "Notice"). On March 7, 2014, the Commission issued Order No. 2009 opening the docket and inviting comments on the proposed contract. Order No. 2009 set the deadline for filing Initial Comments as March 27, 2014. Valpak Direct Marketing Systems, Inc. and Valpak Dealers' Association, Inc. (hereinafter "Valpak") hereby file their Initial Comments regarding the PHI NSA, subject to supplementation when the record is complete, or any extension is granted.

VALPAK MAILING PRACTICES

Valpak has participated actively in Commission dockets for nearly 19 years. Valpak has submitted comments in each annual compliance review under the Postal Accountability and Enhancement Act ("PAEA"), and various pricing dockets, including other negotiated service agreements ("NSAs"). Valpak is a heavy user of Standard Mail, which includes the products

upon which the PHI NSA is based. Valpak primarily uses the High Density/Saturation Letters product, which had one of the highest cost coverages of any product in FY 2013 — 235.8 percent. Valpak Dealers' Association, Inc. is an association of about 175 independently owned franchises across North America, assisting more than 50,000 small business advertisers in promoting their products and services. Valpak's annual volume has declined in recent years, to 466.0 million pieces in 2012, of which approximately 93 percent is at the saturation rate, and over 99 percent of which is SCF-entered.

SUPPORT FOR PUBLIC REPRESENTATIVE REQUEST FOR EXTENSION OF TIME

For the reasons set forth in sections I and II below, Valpak supports the PR's request filed today for an extension of time to file initial and reply comments in this docket contained in its Answer to Postal Service Motion for Late Acceptance and Motion for Extension of Comment Deadlines (Mar. 27, 2014). Nevertheless, Valpak submits that the following Initial Comments, subject to later amplification based on a complete record.

COMMENTS

I. The Postal Service's Notice in this Docket Fails to Provide Information Required by Commission Rules.

The Postal Service's Notice fails to provide the minimum information required by Commission Rules and otherwise fails to conform with Commission Rules. This docket is not the first instance of the Postal Service submitting an incomplete filing to the Commission, withholding important information about its proposal until forced to reveal that information late in a docket. Indeed, this has become an established pattern, or standard operating procedure for the Postal Service. For these reasons, the Commission should dismiss the Postal Service's

request, without prejudice to refile another Notice in full compliance with Commission Rules. At the very least, the Commission should put the Postal Service on notice that any future NSA or other filing initiating a docket which is incomplete in any respect, or does not fully comply with Commission Rules in any respect, will be summarily dismissed without prejudice. Consider the following items in the instant docket.

First, the Postal Service failed to provide the required information in its data collection plan. Chairman's Information Request ("ChIR") No. 1, question 1, asks how the data collection plan in Attachment D of the Notice complies with 39 C.F.R. § 3010.43(b). Attachment D identified certain data reporting, but it excludes any cost data and does not appear to comply with what is required by the Rule. Although ChIR No. 1 asked about compliance with Rule 3010.43(b), the Postal Service responded with reference to Rule 3010.43(a). The Postal Service must be required to comply with the reporting requirements or the NSA should be rejected. Moreover, the Postal Service has been uneven in meeting similar reporting deadlines in the past.¹ *See generally* Docket No. ACR2013, Initial Comments of Newspaper Association of America.

Second, 39 C.F.R. § 3010.42(f)(3) requires the Postal Service to submit with its request "An analysis of the effects of the negotiated service agreement on the contribution to institutional costs from mailers not party to the agreement." ChIR No. 1, question 3, asked

¹ The data collection plan in Attachment D provides for the filing of the data "Not later than **90 days** after the end of the contract year." (Emphasis added.) This is in direct conflict with section 3010.43(b), which specifies that "A data report under the plan is due **60 days** after each anniversary date of implementation." (Emphasis added.) The Postal Service termed this substantive discrepancy a typographical error. *See* Postal Service Response to ChIR No. 1, question 1 (Mar. 26, 2014).

the Postal Service to identify the location of that information in the Notice. Of course, the information is not there. The Postal Service brushed this failure aside, claiming it expects no change in contribution from mailers not party to the NSA, “thus, no analysis was provided.” Response of Postal Service to ChIR No. 1, question 3 (Mar. 26, 2014). PHI Acquisitions, Inc. is a privately held corporation, and little can be learned about it other than that it is located in Chelmsford, Massachusetts, and that it provides Internet and catalog services. The only information provided with the Postal Service’s filing is a list of catalogs to be mailed by PHI under the NSA agreement. *See* Attachment B, p. 2. Based on the information provided in the NSA filing, it is impossible to know if offering PHI an NSA with substantial postage discounts will have an adverse effect on PHI’s competitors. It should not simply be assumed, as the Postal Service has done, that it will have absolutely no effect on any other mailer.

Third, 39 C.F.R. § 3010.42(g) requires the Postal Service to identify the component of the NSA that is expected to enhance the performance of mail preparation, processing, transportation, and other postal functions, as required by 39 U.S.C. § 3622(c)(10)(A)(ii) as an alternative to the requirement regarding the net financial position of the Postal Service. ChIR No. 1, question 4, asks the Postal Service to provide the required information because it is not in the Notice. Other than the general “enhance[ment in] the preparation of all Flats mail,” there is nothing in the NSA designed to enhance Postal Service performance. At last, yesterday, March 26, 2014, the Postal Service for the first time in this docket confirmed it is not attempting to justify the NSA based on anything other than net revenue gains despite ambiguous statements about performance benefits. *See* Postal Service Response to ChIR No. 1, question 4.

Fourth, the Commission's rules generally require the Postal Service to use Commission-approved methodology, with some exceptions: "The projection of change in net financial position as a result of the agreement shall be based on accepted analytical principles." 39 C.F.R. § 3010.42(f). Alternatively, if the Postal Service believes that the Commission's methodology is not the most accurate and reliable, then the Postal Service must explain why and provide its alternative methodology. 39 C.F.R. § 3010.42(f)(5). The Postal Service's Notice provides a projected net financial position, showing an aggregate net increase in contribution over the five-year contract of \$10.748 million. ChIR No. 2, question 1,² states that the "methodology in the Postal Service's workpapers ... does not conform to the Commission approved methodology affirmed in Order No. 738." No submission as to the central issue for this NSA, its effect on net contribution, was made using Commission-approved methodology. This information was omitted from the Postal Service Response to ChIR No. 2 filed today. The absence of this information also requires rejection of this NSA.

Fifth, the Postal Service proposes that this NSA last for five years. All prior NSAs have been for three years. Yet there is not a word of description as to why this highly significant change was made. This may be a very bad idea indeed, as the Postal Service has demonstrated that it will not terminate an NSA even when it is losing significant money.

Sixth, the Postal Service's response to ChIR No. 1, Question 7, provides virtually no information as to which mailers will be considered similarly situated. That question identified four aspects of the PHI NSA, and the Postal Service simply said that all of those aspects "are

² This question was a modified version of what the Public Representative proposed in his Motion for Issuance of Information Request (Mar. 19, 2014).

all key aspects of this Agreement to be used in determining whether another mailer is deemed to be “similarly situated” to PHI.” This answer tells mailers nothing as to which mailers would be entitled to a functionally equivalent NSA — reserving to the Postal Service the unlimited discretion to decide who to favor with such an NSA — contrary to the requirement of 39 U.S.C. section 3622(c)(10).

On all of these issues, the Postal Service bears the burden of proof. NSAs cannot be approved simply because the Public Representative or a mailer has not established that the law is violated. The burden is on the Postal Service as the proponent to establish Title 39 is fully complied with.

The omissions above are neither new nor isolated occurrences. In context, they constitute a pattern of blatant disregard for Commission Rules, which have adverse consequences on other mailers and the Commission.

II. Incomplete Postal Service Filings Make Public Participation Difficult or Impossible.

The fact that the Postal Service’s filing in this docket was neither complete nor in compliance with Commission Rules was demonstrated in section I, *supra*. The consequences of freely allowing the Postal Service to remedy such failures is discussed in this section.

A. The Postal Service Benefits from Failing to Disclose Information at the Outset of a Docket.

An incomplete Postal Service filing can be handled by the Commission in one of two ways.

First, the Commission could dismiss the filing as inadequate and improper, without prejudice to refile. Such an approach builds respect for Commission Rules, as the Postal

Service knows that violation of rules will not be tolerated, and will only result in delay in obtaining Commission review. With the clock reset with each new filing, or refiling, the Postal Service gains nothing by omitting information from its initial filing.

Alternatively, the Commission could give the Postal Service an opportunity to supplement its initial filing to remedy omissions and other rule violations, through requests for information issued by either the Chairman or the Commission. (Indeed, sometimes, more than one request for the same information has been required.) Unfortunately, under this approach, when the information is submitted, it is considered on the same par as information that was provided at the beginning. Such an approach breeds disrespect for Commission Rules. It removes from the table the risk of incurring any meaningful sanction from the Commission for incomplete filings.

Indeed, the result of this recurring dance between the Postal Service and the Commission is that the Postal Service not only has no incentive to provide information in its initial request, but even worse, that it has every incentive not to do so. It would be a mistake to believe that the Postal Service has not noticed, and has not adapted to, the perverse incentive structure for noncompliance that the Commission has perhaps inadvertently established through the way it has responded to incomplete Postal Service filings in prior dockets. Noncompliance has become the standard operating procedure.

B. Both Mailers and the Commission Lose from the Postal Service Failing to Disclose Information in a Timely Fashion.

Moreover, it would be a mistake to believe that there are no losers as a result of the Commission's laxness in enforcing its own rules. Commission Rules and established practice

provide mailers and interested parties the opportunity to propose questions to be asked to the Postal Service, and to provide comments on most dockets, such those Mail Classification Dockets considering NSA proposals. The Commission is required to issue a decision in an NSA docket within 45 days from the date of its filing. The deadline between the date of filing by the Postal Service and the date for mailers to propose questions or to file their comments is quite short — 22 days in this case. The ability of a mailer to ask the right question, or to make cogent comments, is dramatically diminished, to the point of being virtually eliminated, by the Postal Service's failure to provide all information with its initial Notice of Filing.

Mailers loss of due process rights is well illustrated by the problems mailers have confronted in this docket, where the Postal Service responses to two ChIRs were due on the two days before the deadline for Initial Comments.

Postal Service responses to ChIR No. 1 were supposed to be filed by March 25, 2014, but were not. Responses were not filed until yesterday, the day before Initial Comments were due, March 26, 2014, and even then, two of the questions posed were not responded to. The Postal Service's motion for late acceptance treats the late filing cavalierly, attributing it to the "need for internal review prior to filing." The Postal Service appears to ignore the mailers' need for information prior to filing their comments. The Postal Service conclusively asserts that "no party has been prejudiced by this brief delay." (The same assertion was made in the Postal Service motion for leave regarding its partial response to ChIR No. 2 filed today, discussed below.) The Postal Service also ignores the difficulty faced by mailers who cannot probe the weaknesses of an NSA because of that delay. The Postal Service's assumption that there is no prejudice in filing supplemental information to an incomplete filing the day before

Initial Comments are due reflects a lack of respect for (or a desire to suppress) mailer input and for the Commission's review process.

The Postal Service responses to ChIR No. 2 were not due until yesterday, March 26, 2014, the day before Initial Comments, but the Postal Service missed that deadline as well. And today, the Postal Service filed only a partial response to ChIR No. 2.

Supplementing incomplete initial filings so close to the deadline limits the ability of the public, possibly including competitors of a party to an NSA, to analyze and provide input to the Commission on the legality of the NSA. The Commission has a duty to protect the role mailers and other commenters play in these dockets.

Moreover, it does not improve the quality of Commission review to receive information at the last minute. This is unfair to the Commissioners and to the Commission staff. It tends to encourage superficial review and potential rubber-stamping of NSA proposals. If some mailers come to expect the Postal Service requests to be rubber-stamped regardless of how incomplete or ill-founded they are, mailers have no incentive to offer comments to the Commission, depriving the Commission of mailer input. Laxity in rules enforcement works against the Commission performing its regulatory function — the very task entrusted to it by Congress. The Commission's job is not to approve NSAs, but rather to review NSAs, and sanction only those which comply with the law.³

The only solution to this recurrent problem is for the Commission to insist that the Postal Service provide complete filings which substantially comply with Commission Rules at

³ If all NSAs are to receive what amounts to rubber-stamp approval, then there really is no need for a Commission at all.

the outset of a case. Although it is within the Commission's discretion to seek additional information to clarify, supplement, and enhance the record through information requests, it is certainly not the Commission's role to remedy inadequate initial filings of the Postal Service. Giving the Postal Service multiple chances to delay complete disclosure enables illegal and abusive behavior by the Postal Service, encouraging the Postal Service to game the system by not providing a complete filing at the outset of its pricing dockets. Such a system violates the due process rights of the public to participate in these dockets, and jeopardizes its ability to perform the type of review Congress entrusted to it.

III. The Small Unit Contributions from the PHI NSA Are Unjustified in the Context of Standard Mail.

The basic discount structure for the proposed PHI NSA is as follows:

- (I) a 10 percent rebate for volume increase up to 10 percent over the baseline;
- (ii) a 15 percent rebate for volume 10.01 percent up to 18 percent over the baseline; and
- (iii) a 20 percent rebate for volume more than 18 percent over the baseline.

For the third-tier discounts, some of the volume incentivized by this NSA will produce only tiny unit contributions. The Commission has asked for Postal Service confirmation that in the fourth and fifth years, the **unit contribution** from the upper discount tier will be **0.2 cents** and **0.3 cents**, respectively, for Carrier Route⁴ mail. *See* ChIR No. 2, question 3; *see also* Public

⁴ In identifying which mail is eligible for the NSA discounts, the Postal Service uses the confusing description "Carrier Route Flats (i.e., Saturation, High Density Plus, High Density, Basic) as well as Flats Sequencing System ('FSS') Flats, which bear a full-service

Representative Motion for Issuance of ChIR (March 19, 2014), p. 4. The coverage being paid by these pieces is barely over 100 percent. The Postal Service appears to be operating on the assumption that volume is necessary regardless of profitability and, it should discount mail which barely makes any contribution. Again, the Postal Service fails to understand that its job is to maximize contribution, not to maximize volume. Moreover, the estimated elasticity of Carrier Route mail eligible for the discount is low.

NSA's unit contribution numbers cited by the Commission are astonishing low. In proposing this NSA, the Postal Service marketing department is telling the Commission that scarce resources, both at the Postal Service and the Commission, are best used in attracting barely profitable volume. It is remarkable that the Postal Service is spending such significant time and effort discounting postage to attract an almost negligible unit contribution. To offer discounts to grow volume on an already marginally profitable product evidences a lack of marketing savvy on the part of the Postal Service.

Although it is essential for each product to cover its cost, if that is all that every product did, the Postal Service would go out of business. Only 54.2 percent of costs are attributable, and therefore the Postal Service must charge an average (systemwide) coverage of 184.6 percent, just to break even. Carrier Route has a cost coverage of 133.4 percent, well below systemwide average, which places it in the category of products which are only

IMb.” The Postal Service repeats the same confusing terminology in its Response to ChIR No.1, question 4. Therefore, the term “Carrier Route” is not used in this NSA as in the established postal lexicon, creating an overlap and creating confusion. Carrier Route is a Standard Mail product, but in the PHI NSA, “Carrier Route Flats” includes mail sent in the Carrier Route product as well as in the High Density/Saturation Flats & Parcels product, and possibly the Standard Flats product. *See* Notice, p. 7.

marginally profitable for the Postal Service. The cost coverage of Carrier Route is also below the average cost coverage of 159.9 percent for all Standard Mail products. It is far below the cost coverage of the two most profitable Standard Mail products⁵: High Density/Saturation Letters (235.8 percent coverage), and High Density/Saturation Flats (229.0 percent coverage). Also, Saturation mail products have the highest elasticities.

Indeed, when all adverse affects of the NSA are calculated, the net revenue could be even worse. The Postal Service filing states: “While PHI’s mail will cover its attributable cost in **virtually all** cases....” USPS Notice, p. 13 (emphasis added). This statement is unexplained. It would be important to learn which of PHI’s mail is losing money, and whether offering the discount even for marginally profitable products might have the unintended effect of stimulating printed catalog value that is entered at, for example, Standard Flats rates, resulting in the Postal Service losing even more money on that product. Any such potential source of revenue loss must be taken into account in evaluating the NSA.

The time and energy of the Postal Service and the Commission being used on an NSA such as this would be better expended on growing the volume of saturation and other highly profitable products, instead of barely profitable products. For example, real benefit to the Postal Service could be achieved by providing an across-the-board discount to saturation mail, which would help grow these highly profitable, highly elastic products, without the favoritism, politics, and administrative burden inherent in granting special NSA discounts to a single mailer.

⁵ Other than EDDM-R.

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