

BEFORE THE
POSTAL REGULATORY COMMISSION
WASHINGTON, DC 20268-0001

Market Dominant Product Prices
Standard Mail
PHI Acquisitions, Inc.

Docket No. MC2014-21

Market Dominant Product Prices
PHI Acquisitions, Inc. (MC2014-21)
Negotiated Service Agreement

Docket No. R2014-6

PUBLIC REPRESENTATIVE REPLY COMMENTS
(April 30, 2014)

I. BACKGROUND

The Postal Service has entered into a market dominant NSA with PHI, and requests the Commission's approval to implement the agreement... The core concept of the PHI market dominant NSA¹ (PHI NSA) is a declining block discount, where the discount increases as the mailer increases its volume. The Postal Service states that the agreement is designed to increase the total contribution the Postal Service receives from PHI Standard Mail Carrier Route Flats volume.²

Only two commenters provided analysis of the PHI NSA in Initial Comments in this docket: Valpak and the Public Representative. Due to the Postal Service's incomplete and heavily modified filings in this docket, Valpak has provided three sets of Initial Comments in this docket. These Reply Comments respond to each of Valpak's filings. In general Valpak raises important issues regarding the deficiencies in the Postal Service's filings.

II. VALPAK INITIAL COMMENTS

¹ On March 5, 2014, the Postal Service filed a request pursuant to 39 U.S.C. 3622 and 3642, as well as 39 CFR 3010 and 3020, *et seq.*, to add a PHI Acquisitions, Inc. (PHI) negotiated service agreement to the market dominant product list. In Order No. 2009, the Commission established the Docket Nos. MC2014-21 and R2014-6 and appointed the undersigned Public Representative.

On March 20 and 21, 2014, the Commission issued CHIRs No. 1 and 2. The Postal Service filed a complete response to CHIRs No.1 and 2 on April 3, 2014. Due to errors and missing information, the Commission issued CHIR No. 3 on April 11, 2014. The Postal Service filed its response on April 16, 2014. In Order No. 2049, the Commission extended the initial comment deadline to April 23, 2014 and established a reply comment deadline of April 30, 2014.

² In the context of this agreement, Carrier Route means Carrier Route, High Density, High Density Plus, and Saturation. This is equivalent to the ECR subclass that existed prior to 2007.

Valpak filed Initial Comments on March 27.³ Valpak commented on three issues, as detailed below.

- a. “The Postal Service’s Notice in this Docket Fails to Provide Information Required by Commission Rules.”⁴ “Incomplete Postal Service Filings Make Public Participation Difficult or Impossible.”⁵

Valpak notes that the Postal Service has not provided many of the items that Commission regulations require the Postal Service include when it requests approval of an NSA. Valpak notes that this is “standard operating procedure for the Postal Service.”⁶ Valpak argues that the Commission should dismiss the Postal Service’s request without prejudice and allow the Postal Service to file another request, one that would comply with the Commission’s rules. Valpak states that “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 full comply with Commission Rules in any respect, will be summarily dismissed without prejudice.”⁷

Since Valpak filed these comments on March 27, the Postal Service has made major revisions to its case. As detailed in the Public Representative Initial Comments, the Postal Service has changed its financial analysis. The Postal Service has provided answers to multiple important CHIR questions that fill in some of the gaps in the record that existed on March 27. There is some public interest in requiring the Postal Service to refile in this docket. The public interest is served by the Postal Service filing a case that comports with applicable rules. The Postal Service’s failure to abide by the rules results in considerable confusion and increases the work required by the public to understand the Postal Service’s proposal.

Valpak states that “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”⁸ The Public Representative agrees. The Postal Service’s initial Notice must, at a

³ Valpak Direct Marketing Systems, Inc. And Valpak Dealers’ Association, Inc. Initial Comments on PHI Acquisitions, Inc. Negotiated Service Agreement (March 27, 2014) (Valpak Initial)

⁴ Valpak Initial at 2.

⁵ Valpak Initial at 6.

⁶ Id. at 2.

⁷ Id. at 3.

⁸ Id at 8.

minimum, set forth how its proposal is supported and comports with the applicable requirements of the law. In this docket, the representations and analysis contained in the Postal Service's Notice are misleading and incorrect. By developing its case through CHIRs and its comments, the Postal Service creates a significant barrier that stakeholders have to overcome to develop meaningful comments.

For competitive NSAs, where public participation is limited and the Postal Service has an incentive for the agreements to be quickly approved so that they can be implemented, the Postal Service provides a complete filing in nearly every docket. Other types of dockets have presented more of a challenge. Valpak is correct to discuss the troublesome nexus between complete filings and public participation. When the Postal Service does not file correct and complete information at the onset of a given docket, the public interest is harmed. The Commission should require the Postal Service to, at a minimum, comport with Commission rules, or explain in detail why it is unable to do so.

b. "The Small Unit Contributions from the PHI NSA Are Unjustified in the Context of Standard Mail."⁹

Valpak notes that, as originally envisioned by the contract, "in the fourth and fifth years [of the contract], the unit contribution from the upper discount tier will be 0.2 cents and 0.3 cents, respectively." Again, the context of the information available to Valpak on March 27 is important. The file "PHI_NSA_Financials_FINAL_Exigent.xls," provided by the Postal Service on April 8, 2014, contains an estimate of the unit contribution from the upper discount tier in contract year five of 1.2 cents. This, as detailed in the Public Representative Initial Comments, assumes that the exigent surcharge is still in effect in contract year 5. So it is possible that Valpak's concern about low contribution mail is misplaced, given the updated information provided by the Postal Service. It is also possible that by contract year 5 the exigent surcharge will no longer be in place, in which case the unit contribution from discounted mail will be low. This line of inquiry highlights the unclear and incomplete information the Postal Service has provided regarding the financial implications of the implementation of this NSA.

Valpak's larger concern is whether this NSA can improve the Postal Service's net

⁹ Valpak Initial at 10.

financial positions. Valpak states “The coverage being paid [the incremental discounted] 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.”¹⁰ Valpak also notes that “the estimated elasticity of Carrier Route mail eligible for the discount is low.”¹¹

As detailed in the Public Representative’s Initial Comments, there is a possibility that this agreement will have a positive financial benefit for the Postal Service. It is possible that the agreement could have been designed to be more profitable for the Postal Service. But, if the Postal Service can successfully clear the pre-implementation hurdles noted by Public Representative in its Initial Comments and financially benefit from the agreement, doing so makes sense. In the best case scenario, the Postal Service could gain up to \$7 million in contribution over the 5 year life of the NSA.¹² The risk that the Postal Service will experience a decrease in net contribution exists, and the Postal Service needs to provide more information to demonstrate that the possible positive outcomes outweigh the possible negative outcomes.¹³ But, it is reasonable for the Postal Service to explore pricing methods that increase contribution. Valpak suggests that there are other pricing avenues that would lead to contribution increases of greater than \$7 million, and the Postal Service should explore those avenues as well.

The Public Representative disagrees with Valpak’s assertion that the estimated elasticity for Carrier Route mail is low. The current elasticity for Carrier Route is among the highest for market dominant products. Carrier Route, High Density, High Density Plus, and Saturation products are grouped into the former ECR subclass for the purposed of producing an elasticity estimate for these products. Valpak states that “Saturation mail products have the highest elasticities.”¹⁴ This NSA targets such

¹⁰ Id. at 11.

¹¹ Id. at 11.

¹² Analysis of contract year 1 using the Commission’s methodology suggests that the Postal Service could increase contribution by \$1.4 million. If the best case scenario is achieved in contract year 1, and repeated for all 5 years, the total would be \$7 million.

¹³ As noted in the Public Representative’s Initial Comments, a discount cap would quantify and minimize the financial risk to the Postal Service of the NSA.

¹⁴ Id at 12

Saturation mail products. The Postal Service has targeted the type of mail that can be expected to respond to a pricing incentive, and this is the primary reason that the NSA may have a positive net financial benefit.

III. VALPAK SUPPLEMENTAL INITIAL COMMENTS

On April 10, 2014, Valpak filed Supplemental Comments.¹⁵ Valpak noted that the Postal Service provided an estimate of net financial benefit for the first year of the agreement of \$735,682 using the Commission's approved methodology. The Postal Service revised this estimate after Valpak filed its Supplemental Comments. Valpak stated "the Postal Service has not provided to the Commission the necessary statutory predicate for approval — a showing that over the life of the NSA it would improve Postal Service net finances."¹⁶ The Public Representative agrees with this concern.

Valpak also notes that "the Commission cannot approve the NSA without knowing about any possible loss of contribution from mailers not party to the NSA, a consideration which was ignored by the Postal Service."¹⁷ The Public Representative agrees with Valpak that the Postal Service is required to, at a minimum, comport with Commission rules, or explain in detail why it is unable to do so.

IV. VALPAK FURTHER SUPPLEMENTAL INITIAL COMMENTS

On April 23, 2014, Valpak submitted Further Supplemental Initial Comments.¹⁸ Valpak states "Neither the Postal Service's responses to CHIR No. 2, question 1, nor its response to CHIR No. 3, question 1 shows the projected change in net financial position for each of the years 2-5 of the proposed NSA, using the Commission-approved methodology. Thus, the Postal Service fails to show the total net value to the Postal Service for the five years of the contract as required by 39 U.S.C. § 3622(c)(10)(A). The Postal Service's failure to comply with the Commission's required filings — now after three opportunities — has forced the Commission to decide the case without adequate record evidence to approve the PHI NSA. For this reason alone, it must be rejected." The Public Representative agrees that the Postal Service must produce an estimate of

¹⁵ Valpak Direct Marketing Systems, Inc. And Valpak Dealers' Association, Inc. Supplemental Initial Comments on PHI Acquisitions, Inc. Negotiated Service Agreement (April 8, 2014) (Valpak Supplemental 1)

¹⁶ Valpak Supplemental 1 at 3.

¹⁷ Id at 3.

¹⁸ Valpak Direct Marketing Systems, Inc. And Valpak Dealers' Association, Inc. Further Supplemental Initial Comments on PHI Acquisitions, Inc. Negotiated Service Agreement (April 23, 2014) (Valpak Supplemental 2)

the financial impact for the entire agreement before the Commission can resolve the current docket. The complex discount threshold adjustment mechanisms in combination with the exigent surcharge provisions have created considerable uncertainty as to the volume that the Postal Service projects PHI will mail in contract years 2-5.

The Postal Service has provided two versions of an analysis the net financial impact of contract year one using the Commissions methodology. Valpak states that “the data that have been submitted make no sense.”¹⁹ Valpak further states that the “Postal Service utterly fails to explain how increases in the marginal discount and total rebate paid increases the total net value to the Postal Service.”²⁰

Valpak is correct that the Postal Service’s initial attempt to apply the Commission’s approved methodology made “no sense.” However, the Public Representative has been able to successfully replicate the Postal Service’s Response to CHIR No. 3. As a marginal discount increases, the volume response to that discount increases. In its response to CHIR No. 3 question 1, the Postal Service made no attempt to explain the differences between its original estimates and its revised estimates.

V. CONCLUSION

In its Initial Comments, Valpak successfully argues that the Postal Service must submit complete filings that comport with Commission Rules. The Commission cannot resolve this docket until the Postal Service has provided an affirmative showing that the agreement complies with applicable law. As of April 30, 2014, the Postal Service has yet to do so.

Respectfully Submitted,
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¹⁹ Valpak Supplemental 2 at 2.

²⁰ Id at 2.