

BEFORE THE
POSTAL RATE COMMISSION
WASHINGTON, D.C. 20268-0001

POSTAL RATE AND FEE CHANGES

Docket No. R2006-1

RESPONSE OF THE UNITED STATES POSTAL SERVICE TO
PRESIDING OFFICER'S INFORMATION REQUEST NO. 12, QUESTIONS 5
AND 15
(September 8, 2006)

The United States Postal Service hereby provides additional responses to
Presiding Officer's Information Request (POIR) No. 12, issued August 24, 2006.
The following witnesses are sponsoring the identified responses to this POIR:

| | |
|------------------|-------------|
| Witness Berkeley | Question 15 |
| Witness Mitchum | Question 5 |

Each question is stated verbatim and is followed by the response.

Respectfully submitted,

UNITED STATES POSTAL SERVICE

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RESPONSE OF POSTAL SERVICE WITNESS MITCHUM
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5. The following table presents three hypothetical users of Confirm service with Gold subscriptions. In order to calculate the rates paid under the current and proposed fee schedule, it is assumed that the volume of units purchased by each user are applied to the same (average) distribution of First-Class Mail and other mail classes.¹

Current Confirm Fee Schedule

| | First-Class Scans (1) | Other Scans (2) | Total Scans (3) | Total Units (4) | Revenue (Current Rates) (5) |
|------------------|----------------------------------|----------------------------|----------------------------|----------------------------|--------------------------------------------|
| User 1 | 19,250,000 | 15,750,000 | 35,000,000 | 98,000,000 | \$ 4,500 |
| User 2 | 19,250,000 | 15,750,000 | 35,000,000 | 98,000,000 | 4,500 |
| User 3 | 19,250,000 | 15,750,000 | 35,000,000 | 98,000,000 | 4,500 |
| Total 1-3 | 57,750,000 | 47,250,000 | 105,000,000 | 294,000,000 | \$ 13,500 |
| Reseller | 57,750,000 | 47,250,000 | 105,000,000 | 294,000,000 | 10,000 |

Proposed Confirm Fee Schedule

| | Total Units (6) | Additional Blocks (7) | Revenue (Proposed Rates) | | | | Total (12) |
|------------------|----------------------------|----------------------------------|---------------------------------|----------------------------|-----------------------------|--------------------------------|-----------------------|
| | | | Base Fee (8) | \$70 Blocks (9) | \$35 Blocks (10) | \$17.50 Blocks (11) | |
| User 1 | 98,000,000 | 97 | \$ 5,000 | \$ 630 | \$ 3,080 | \$ - | \$ 8,710 |
| User 2 | 98,000,000 | 97 | 5,000 | 630 | 3,080 | - | 8,710 |
| User 3 | 98,000,000 | 97 | 5,000 | 630 | 3,080 | - | 8,710 |
| Total 1-3 | 294,000,000 | 291 | \$ 15,000 | \$ 1,890 | \$ 9,240 | \$ - | \$ 26,130 |
| Reseller | 294,000,000 | 293 | 5,000 | 630 | 3,185 | 3,378 | 12,193 |

Note: The total units listed in columns (4) and (6) is the number necessary under the proposal to obtain the number of scans in column (3), as distributed in columns (1) and (2).

- a. Please confirm that, under the proposed fee schedule, the potential for arbitrage exists. For example, an entity could purchase 294,000,000 units for a total price of \$12,193 and sell 98,000,000 to each of users 1-3 for a price as low as \$6,065 ($(\$12,193 \div 3) + \$2,000$ additional annual ID = \$6,065), thereby undercutting the price of \$8,710 that the Postal Service would charge. Note that this example assumes the reseller is not itself a user of Confirm. If the reseller purchases additional scans for its own use, the potential for arbitrage increases.

¹ See Response of Postal Service Witness Mitchum to Interrogatories of the Office of the Consumer Advocate, July 24, 2006, OCA/USPS-T40-54(b) (indicating that 55 percent of the scans would be on First-Class Mail and the remaining 45 percent on other classes).

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- b. Please discuss how the potential for arbitrage by resellers of Confirm services (as demonstrated in part a. above) entered into the analysis underlying the rationale for assuming that high-volume and low-volume users would respond to the proposal with equal percentage reductions in scans.
- c. Please discuss whether the risk of arbitrage is greater under the existing or the proposed fee schedule.

RESPONSE:

I believe there is a small calculation error in the reseller line of columns 10 and 11. It appears that the calculation is 91 blocks at a fee of \$35 for the \$3,185. I believe this should have been 90 blocks at \$35 for a total of \$3,150. Also, the value in column 11 should be \$3,395 (194 blocks at \$17.50 each).

a. Confirmed, although technically "arbitrage" involves the purchase and immediate resale of a security. In the case of Confirm, arbitrage is not as simple as it appears. The intermediary would incur additional costs even if they did nothing more than relay the raw scan data to the end user. However it is my belief that Confirm intermediaries are often providing value added services to their customers by providing them with reports based on the analysis of the scans their customers' mailpieces receive, as GrayHair Software Inc. notes that it does in the direct testimony submitted by Cameron Bellamy on page 4, lines 16-18, of GHS-T-1. As such, I think that their customers are not choosing to use an intermediary to receive a discounted price, but instead are using the intermediary for the value added services provided.

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b. As noted in my response to part (a) of this question, I don't think that arbitrage plays much of a role for Confirm intermediaries (resellers), and therefore I did not differentiate among users regarding their decrease in scan usage. However, the existing arbitrage opportunity did play a role in the decision to move away from the current unlimited scan option. All else equal, if additional scans are priced at zero (as in the current Platinum subscription), then the opportunity to gain from reselling is larger than if there is at least some additional price for incremental scans.

Please refer to my responses to questions 6(b) and 7 of this Presiding Officer's Information Request with regard to how the expected decrease in the numbers of scans is taken into consideration.

c. It is my opinion that the opportunity for arbitrage is greater under the existing fee schedule. However, I think the gains from reselling are based more on the added services provided than the arbitrage opportunity. In any event, by evaluating the arbitrage opportunity under two additional scenarios, I believe it can be clearly shown that the proposed fee schedule reduces the arbitrage opportunity.

The arbitrage opportunity described in this question might exist, but this hypothetical is not particularly realistic. A reseller is unlikely to have only 3 customers. Using another hypothetical, a reseller using 805 million scans in a year could have 23 customers that use 35 million scans each. In this case the maximum value of the arbitrage opportunity

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is \$153,855, assuming that the fees under the existing structure are increased by 50 percent (to achieve the same revenue goal, with no loss in demand).² The maximum value of the arbitrage opportunity under the proposed fee schedule would be \$153,750, \$105 less than the opportunity under the existing fee design. While the arbitrage opportunity is similar, the Postal Service would get \$31,475 of additional revenue under the proposed structure versus the existing structure with increased prices.

The specific assumptions are:

- Under the existing structure, with the fees increased by 50 percent, there would be 23 customers paying \$6,750 for a total revenue of \$168,750. Alternatively, a reseller could provide the scan data to the 23 customers and pay just \$15,000. The maximum arbitrage opportunity would be \$153,750 (\$168,750-\$15,000).
- Under the proposed fee schedule, these 23 customers would each pay \$8,710 for a total revenue of \$200,330. A reseller would have to pay just \$46,475. The maximum arbitrage value would be \$153,885 (\$200,330-\$46,475).

Even the revised hypothetical, with 23 subscribers, is unlikely since there are not enough users of that size currently subscribing to the service to make the hypothetical feasible. Additionally, OCA XE – Mitchum - #1 (Tr. 14/4147) clearly shows that

² In order to have a more direct comparison between the current and proposed structure, it is necessary to build in some assumption about price increases that would occur in the current structure.

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TrackMyMail.com markets, at least in part, to much smaller customers. So if, as another hypothetical, we consider a reseller that has 100 customers that on average use 8 million scans each, it quickly becomes evident that the arbitrage opportunity under the existing fee structure, even with the fees increased by 50 percent, is much greater than under the proposed fee schedule. The maximum value of the arbitrage opportunity is \$660,000 under the existing fee structure with the fees increased, and only \$539,520 under the proposed fee schedule. The Postal Service, moreover, would receive an additional \$31,230 under the proposed fee schedule.

The specific assumptions are:

- Under the existing structure, with the fees increased by 50 percent, there would be 100 customers paying \$6,750 for a total revenue of \$675,000. The reseller would pay just \$15,000. The maximum arbitrage opportunity would be \$660,000 ($\$675,000 - \$15,000$).
- Under the proposed fee schedule there would be 100 customers each paying \$5,857.50 for a total revenue of \$585,750. A reseller would pay just \$46,230. The maximum arbitrage value would be \$539,520 ($\$585,750 - \$46,230$).

While it is clear that the proposed fee schedule does not eliminate the arbitrage opportunity, it does reduce the value of the opportunity. Yet, as noted in my response to part (a), the intermediaries are not making their profits solely off of the arbitrage opportunity. If arbitrage were the sole business plan being pursued by the

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intermediaries, it is unlikely that the Postal Service would have any direct (non-reseller) subscribers. Intermediaries are providing a value added service by providing either basic or detailed analysis of the customers' scan data. Additionally, "each reseller must find a way to distinguish itself, adding more choices in the market offerings" (GHS-T-1, page 5, lines 20-22) to maintain their market share. This should benefit all Confirm users.

**RESPONSE OF POSTAL SERVICE WITNESS BERKELEY (USPS-T-39) TO
PRESIDING OFFICER’S INFORMATION REQUEST NO. 12**

15. DMCS Collection on Delivery § 944.34 states that “[t]he mailer may receive a notice of nondelivery if the piece mailed is endorsed appropriately.” Due to the placement of § 944.34 under Included Services (with COD) and the section’s language, § 944.34 might be interpreted as providing a notice of nondelivery at no cost to the mailer; however, a notice of nondelivery costs \$3.45 under proposed Fee Schedule 944. Would moving the language from Included Services (§ 944.34) to Other Services (which would require creating a new section — § 944.52) and adding language, as emphasized below, clarify that a fee is collected for a notice of nondelivery?

944.52 The mailer may receive a notice of nondelivery if the piece mailed is endorsed properly **and the appropriate fee as set forth in Fee Schedule 944 is paid.**

RESPONSE:

A notice of non-delivery is part of Collect on Delivery (COD) service, rather than an additional (separate) special service. While a notice of non-delivery has its own fee, that fee is specified in Fee Schedule 944 for COD service, rather than a fee schedule for another service. Therefore, the Postal Service believes it is appropriate that DMCS 944.34 remain in DMCS 944.3 as an included service. Following the approach in DMCS 944.35, the Postal Service would support adding to DMCS 944.34 the language “and the appropriate fee as set forth in Fee Schedule 944 is paid.”