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

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REPOSITIONABLE NOTES PROVISIONAL SERVICE

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Docket No. MC2004-5

**REPLY BRIEF OF THE  
UNITED STATES POSTAL SERVICE**

UNITED STATES POSTAL SERVICE

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## INTRODUCTION

The Postal Service hereby replies to the the Initial Brief of the Direct Marketing Association, Inc., the Association for Postal Commerce, the Magazine Publishers of America, Inc., and the Mailing & Fulfillment Service Association.<sup>1</sup> If the Postal Service determines a reply is needed to the Statement In Lieu of Brief by the National Newspaper Association,<sup>2</sup> that will be provided seven days after that Statement was filed.

When the Commission earlier in this proceeding denied the motion to dismiss filed by three of the four associations filing the joint brief, it put to rest the argument advanced by the joint movants that the Commission may not recommend rates based on characteristics other than cost.<sup>3</sup> The Commission indicated that it would base its recommendation in this case, as it should, on the record. The joint brief now resorts to a series of arguments that are not consistent with the record that is actually before the Commission

Distilled, the Mailers contentions form two basic arguments: (1) that the Postal Service's proposal is not consistent with the statutory scheme because it is, somehow, unauthorized as a request for change that the Postal Service may legitimately pursue through statutory and Commission procedures for rate and classification changes; and (2) that the proposal is unsupported by the record.

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Hereinafter, "the joint brief" or "JB" (October 22, 2004).

<sup>2</sup> Hereinafter, "NNA Statement" (October 26, 2004).

<sup>3</sup> Order No. 1419, at 4-5.

I. The Request is Not Unauthorized

The joint brief invents the appellation “mini rate case” to apply to this proposal.<sup>4</sup> The Postal Service notes that the argument made by the joint movants that it is somehow impermissible for rates to be changed in such a way that might affect the relative contributions of subclasses between omnibus rate cases already failed to persuade the Commission to dismiss this proceeding.<sup>5</sup> Moreover, it is belied by the numerous times the Commission’s recommendations have affected rates, and presumably relative cost coverages, between rate cases. Yet the joint brief argues that the “proper context” for considering this proposal is the “forthcoming omnibus rate case.”<sup>6</sup> It makes no sense for the joint brief to advance arguments that would restrict the Commission from recommending, and thereby the Postal Service from implementing, new services or discounts between omnibus rate cases.

The Postal Service is asking the Commission to recommend the provisional establishment of a new classification with attendant rates. There is nothing improper or unprecedented in this. The Commission’s rules for expedited procedures have resulted in recent years in several new services, both permanent and experimental, between rate cases, with new rates for those services.<sup>7</sup> The joint brief, for the first time in this proceeding, challenges the Commission’s finding that the proposal can appropriately be considered under the rules for provisional services.<sup>8</sup> The joint brief asserts that the

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<sup>4</sup> JB at 3.

<sup>5</sup> See Order No. 1417 (August 30, 2004).

<sup>6</sup> JB at 6.

<sup>7</sup> Experimental Parcel Return Services (Docket No. MC2003-2); Customized Market Mail (Docket No. MC2003-1); Mailing Online Experiment (Docket No. MC2000-2); Bulk Parcel Return Service (Docket Nos. MC99-4 and MC97-4).

<sup>8</sup> Order No. 1413 (July 21, 2004).

proposal does not meet the criteria for a provisional service (or for a market test or an experiment), but fails entirely to specify which criteria are not met. In the face of the Commission's finding in Order No. 1413, this assertion is untimely and unsupported.

The joint brief repeats, as a mantra, that the Postal Service in this case is seeking to "impose" a charge.<sup>9</sup> This characterization is inconsistent with the facts on the record. Through the present time, mailpieces with RPNs attached have been subject to three stages of testing: engineering tests, a one-year limited-participation pilot test on live mail, and then the current phase of broader, open-participation, live testing, which remains limited to automation-compatible letter-sized First-Class Mail and Standard Mail.<sup>10</sup> The next stage of testing, for which a recommendation has been requested in this docket, is intended to expand the availability of RPNs, but only provisionally as part of a one-year test in the actual marketplace. The service would be made available to flats and to non-automation compatible letters, and to Periodicals as well as First-Class Mail and Standard Mail.<sup>11</sup> Based on the results of market research, discussed below, the Postal Service is also proposing a nominal rate for the attachment of RPNs.<sup>12</sup>

The joint brief argues that this case is really a "rate case," because if there were no charge for attaching RPNs, there would be no need for the classification or this proceeding. The joint brief characterizes the Postal Service's proposal as a ruse to "impose fees on a particular group of mailers under the guise of conducting a 'market

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<sup>9</sup> JB at 3, 4, 5, 13, 16.

<sup>10</sup> Domestic Mail Manual § C810.7; see USPS-T-1, at 2.

<sup>11</sup> USPS-T-1, at 3.

<sup>12</sup> *Id.* at 4;

test.”<sup>13</sup> But the participating mailers voluntarily participated in the various test phases and understood that as in any test, the features of the service were subject to change. While the current phase is embodied in the DMM and is more open, there remain limitations: RPNs are permitted only automation-compatible letters in First-Class Mail and Standard Mail. Moreover, simply because the current RPN service is set forth in the DMM, there is no assurance that the status quo will necessarily continue if the Commission does as the joint brief urges and decides not to recommend establishment of the RPN classifications. In that case, the continued permissibility of RPN attachments would be subject to the Postal Service’s unilateral authority over the DMM provisions, including the authority to eliminate or restrict them.

## II. The Proposal is Supported on the Record .

The joint brief’s other mantra is that there is no record support for the proposal. The record shows otherwise. The record itself belies this contention

### A. The Market Research Shows that Mailers View a Rate for RPNs as Rational and the Particular Rates Proposed as Reasonable

The record clearly shows that the actual mailers who participated in the market research did not have the negative response to the concept demonstrated in the joint brief and the earlier motion to dismiss. The evidence in this case shows the study participants “view incremental postage as part of a rational equation.” Moreover, the record shows:

*On an unaided basis, i.e., without having been presented any price points, participants said they would be willing to pay, on average, an additional \$.04 per piece, based on achieving a 10% lift (response rate increase), and \$.07 per piece, based on achieving a 30% lift for First-Class Mail. On*

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<sup>13</sup> JB at 16 (emphasis added).

Standard Mail, they would be willing to pay less on average—about \$.03 assuming a 10% lift and about \$.05 at a 30% lift.<sup>14</sup>

When asked about paying a rate for RPNs that is three times that proposed in this case for First-Class Mail RPNs, “more than three-quarters of [the participants] say they would” use RPNs at 1.5 cents per piece, even without any increase in response rates.”<sup>15</sup> Ninety percent of them said they would use RPNs at 0.5 cents.<sup>16</sup> And almost three-quarters of the participants using a Standard Mail indicated a desire to use RPNs at the proposed price of 1.5 cents.<sup>17</sup>

#### B. Value of Service Justifies a Rate Distinction

The joint brief argues:

The Postal Service at no time explains why it is consistent with the principles of the Act to charge an extra fee solely because response rates may, perhaps, be higher when RPN's are used. The implications of such an approach to pricing RPN's are totally unexplored on this record.<sup>18</sup>

Quite to the contrary, witness Kaneer clearly explains that the rates are based in large part on the value of service to the mailers and recipients, which is, quite clearly, one of the ratemaking criteria of the Act.<sup>19</sup> He states, as the market research shows, that the value to the mailers is based in large part on increased response rates.<sup>20</sup> To ignore this evidence, as does the joint brief, yet at the same time to seize upon reports of mixed results for RPN use by various types of

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<sup>14</sup> USPS-LR-1 (Opinion Research Corporation: “Repositionable Notes (RPN) Concept Research Report” (May 2004) at 37.

<sup>15</sup> *Id.* at 70.

<sup>16</sup> *Id.*

<sup>17</sup> *Id.*

<sup>18</sup> JB at 7.

<sup>19</sup> 39 U.S.C. § 3622(b)(2).

<sup>20</sup> USPS-T-2, at 4, 5, 6, 8.

companies and upon the Postal Service's lack of a volume forecast is to turn the purpose of this proceeding on its head. The shared purpose of the rules for experimental-type services (experiments, market tests and provisional services) is to give the Postal Service an opportunity to examine those very questions, including various aspects of mailer reaction, including the quantity ultimately demanded. An argument that the lack of this information creates a basis for the Commission refuse to recommend the classification patently has no merit.

For the joint brief to allege, in the face of this record, that there is no evidence supporting the value of this service, is simply wrong. Both Postal Service witnesses provide evidence supporting this notion. Strangely, the joint brief ignores most of the market research on the record, yet urges more market research, in lieu of an actual test of the service.<sup>21</sup>

#### C. The No-Fee Alternative Accomplishes Nothing New

In making its alternative proposal, the joint brief fails completely to explain how offering RPNs for free will establish any useful information about demand at a particular price point. The Postal Service is well aware of generalized and anecdotal mailer interest. The Postal Service invested in market research to zero in more specifically on mailer interest and *likely* response. The time has now come to gauge *actual* mailer response in the marketplace. That can be done the way the Postal Service proposes, but will not be possible under the joint brief's alternative proposal of establishing the service at a rate of zero cents.

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<sup>21</sup> JB at 14-15.

The joint brief criticizes the Postal Service for not explaining on the record the “implications” of the value of service approach to pricing RPNs. If those participants truly believed there were implications that needed to be considered by the Commission, they should have filed testimony setting forth and explaining their concerns or at least attempt to explore those issues in discovery in a timely fashion. Not one fact-based statement has been proffered among the record evidence to support the notion that the sky or some part thereof will fall if RPN prices are established in the manner proposed by the Postal Service. And the notion that some potential harm will be unleashed by establishing a rate for mailers wishing to use a completely optional service that they find valuable, regardless of the cost or lack thereof to the Postal Service, seems far fetched at best. If the associations had rational fears, they should have put the factual bases for such fears on the record of this proceeding. Whether through inadvertence or neglect, the factual record set forth by the Postal Service remains almost completely unchallenged.

The joint brief selectively quotes witness Kaneer, alleging that he stated that “The RPN classifications and rates... provided an effective way to garner revenue....”<sup>22</sup> What he said was that given the value of RPNs to the senders and receivers, the RPN classifications and rates would provide an effective way to garner revenue reflective of that value.<sup>23</sup>

#### D. The Joint Brief’s Risk Analysis Is Unfounded.

Using their misstatement of witness Kaneer’s testimony and the Postal Service’s goals, the joint brief constructs its own new theory of postal ratemaking based on

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<sup>22</sup>JB at 7.

relative risks and rewards.<sup>24</sup> According to this view, the primary focus must be on the risk that RPNs might not produce any of the enhanced value that mailers hope to obtain through higher response rates. The joint brief's proposed response to this risk is to compel the Postal Service to forgo recovery of any fee revenue by imposing no fee. This is viewed as appropriate because, if there were no lift in response rates, neither the mailer nor the Postal Service would have benefited. The joint brief appears to assume that basing analysis on the worst-case scenario is necessary because it allows the inherent risk to be shared appropriately.

The joint brief's approach to risk/reward analysis does not withstand scrutiny. If RPNs do not generate any improvement in response rates, the entire RPN concept has no utility, and will quickly be abandoned by mailers. If the service is inevitably doomed, the Postal Service, contrary to what the joint brief is suggesting, will gain no material benefits from the experiment. (As soon as RPN mailings stop, RPN fee revenues disappear.) In these circumstances, mailers should be indifferent as to whether any RPN fee is charged or not, because they simply will not be using the service. The mere fact that mailers are not indifferent, however, is in and of itself indicative of their expectation that the concept has some merit.

This is not to say that there are no risks involved in the experiment. As the joint brief contends, there is uncertainty regarding improvement in response rates (sometimes referred to as "lift"). One risk is that if the average lift is relatively small, a relatively high fee could more than offset achievable benefits, and most potential customers would be driven from the market. On the other hand, if the average lift is

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<sup>23</sup> USPS-T-2, at 2-3.

substantial, a relatively small fee could allow mailers enjoying significant increases in value to achieve that value at a price much less than they would be willing to pay. In proposing its fees, the Postal Service has tried to balance these risks. The market research was conducted precisely to assist in that balancing effort. The joint brief, however, cites no evidence that any alternative fees (as opposed to no fee) would constitute a better resolution.

Under the no-fee proposal, all of the rewards of a successful experiment would accrue to RPN mailers. The joint brief avoids dealing with this side of the coin by concocting a hypothetical NSA in which one of the elements of the contract is an explicit agreement by the mailer “to mail additional pieces of mail bearing RPNs.” Under this hypothetical scenario, the Postal Service “gains financially through increased volume.”<sup>25</sup> In reality, however, there is no NSA and, correspondingly, there is no promise by any mailer to tender additional pieces of mail.<sup>26</sup> The sole mechanism identified by the joint brief as the one by which the Postal Service can expect to achieve its reward under the no-fee alternative has been eliminated from the equation. In attempting to shift the focus towards trying to ensure that the Postal Service receives nothing if the experiment does not work, the joint brief would have the Commission totally gloss over the fact that, if the experiment were successful, their approach might allow all of the increased value to accrue to RPN mailers.

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<sup>24</sup> JB at 8-10.

<sup>25</sup> JB at 9.

<sup>26</sup> Such a scenario is extremely unlikely because mailers need to test RPNs too before they could commit to any threshold amount. More fundamentally, the nature of the product is such that it must be used prudently. If every mailing has an RPN, they would quickly lose their desired effect of calling attention to the mailpiece and differentiating it from other pieces in the mailbox. See Holland, USPS-T-1, at 1.

The joint brief erroneously alleges that “there is none of the appropriate reciprocity in the Postal Service’s RPN proposal.”<sup>27</sup> In fact, there is ample reciprocity in the Postal Service’s proposal. On the one hand, mailers who expect no or insufficient increase in value from RPNs need not participate. On the other hand, mailers who believe that there might be sufficient increase in value from RPNs can pay the fee and test that belief. They can apply RPNs to as many or as few pieces of mail as they choose. Depending on the results they obtain, they may expand or they may curtail their use of RPNs on subsequent mailings. Over time, mailers who experience enhanced value from the use of RPNs will continue to employ them, and will share that increase in value by paying RPN fees and thereby making an enhanced contribution to the recovery of institutional costs. If no mailers experience sufficient enhanced value, sustained RPN usage will not materialize, and the experiment will fail. The risk of that failure falls equally on the mailers and the Postal Service.

More importantly, the benefits of success would likewise accrue both to mailers and the Postal Service, although, in reality, what may initially appear to be the benefit to the Postal Service (fee revenue) is ultimately all shared by all mailers as a reduction in the overall institutional cost burden. The rhetoric of the joint brief notwithstanding, the Act’s breakeven mandate ensures over time that the Postal Service retains no reward from RPN fee revenue in terms of an improvement in its bottom line. Instead, the only lasting reward is a distribution of the institutional cost burden which better reflects the value of the service level chosen by individual mailers

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<sup>27</sup> JB at 9.

As with any type of mail, mailers pay the Postal Service in advance for processing and delivering the mail. The rates paid embody an element of the value of the mailpiece, but do not vary based on the ultimate success of the advertisement within.

### III. The Provisional Service Will Provide Useful Information and Will Be “Provisional”

The joint brief criticizes the Postal Service’s proposal for an actual market test as unnecessary. Instead the Postal Service should provide the service for free and do additional market research.<sup>28</sup> The provisional service is designed to test the Postal Service’s preliminary conclusion that there is demand for RPNs at a modest price. The provisional service will test that in the actual marketplace, which is the only way to know for sure.

While the test will provide volume and revenue data, the Postal Service has not asserted that it will provide elasticities, but it assuredly will provide information about demand. That information can then be used to determine the next step. It is hard to understand how the joint brief’s alternative proposal will measure demand by giving the product away for free and then doing further market research, while can’t measure actual demand.

While the joint brief overstates the matter, the Postal Service sees no need to challenge the notion that approval of a provisional service is indeed provisional. The Postal Service sees no need for the joint brief to urge the Commission and for the Commission to “make clear that ... it will require the Postal Service to ... meet the

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<sup>28</sup> JB at 12-14.

standards for a permanent classification” if the Postal Service requests same in the future.”<sup>29</sup> This seems self-evident.

There seems to be an inchoate fear running through the joint brief that this case would establish a precedent that will lead to some harmful, but unspecified result or condition. Such fears are unfounded. A recommendation by the Commission of a provisional offering of RPNs with attendant rates does not mean that any other future product innovations would necessarily be approved with attendant rates. The Commission will undoubtedly evaluate each case on its own merits and apply the statutory criteria to the facts of each case.

Accordingly, the joint brief provides no basis for the Commission to refrain from recommending the provisional service as set forth by the Postal Service.

Respectfully submitted,

UNITED STATES POSTAL SERVICE

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### **CERTIFICATE OF SERVICE**

I hereby certify that I have this day served the foregoing document upon all participants of record in this proceeding in accordance with section 12 of the Rules of Practice.

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<sup>29</sup> JB at 18.