

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

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POSTAL RATE COMMISSION  
OFFICE OF THE SECRETARY

MAILING ONLINE EXPERIMENT

Docket No. MC2000-2

RESPONSE OF UNITED STATES POSTAL SERVICE  
TO PRESIDING OFFICER'S INFORMATION REQUEST NO. 1  
(December 28, 1999)

Presiding Officer's Information Request No. 1 (POIR1) in this docket was issued on December 16, 1999, directing that responses be filed by December 28, 1999. The United States Postal Service hereby provides the response of witness Plunkett to question 1, witness Poellnitz to question 2, and an institutional response to question 3.<sup>1</sup>

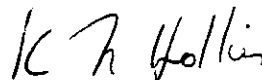
Each information request is stated verbatim, followed by its response.

Respectfully submitted,

UNITED STATES POSTAL SERVICE

By its attorneys:

Daniel J. Foucheaux, Jr.  
Chief Counsel, Ratemaking



Kenneth N. Hollies

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<sup>1</sup>While POIR1 directed that answers be provided by witnesses, the response to question three consists of legal argument and explanation. As such, it is offered as an institutional response rather than from a witness.

**RESPONSE OF POSTAL SERVICE WITNESS PLUNKETT  
TO PRESIDING OFFICER'S INFORMATION REQUEST NO. 1**

**Question 1.** The Commission marks up attributable costs to estimate revenue for subclasses and special services. In Docket No. 97-1, the Commission includes both volume variable costs and product specific costs in defining attributable costs. Please confirm that the 119.4% calculated in USPS T-5, Exhibit D at line 9, provides the implicit markup of 19.4% if product specific costs are included in the definition of attributable costs used by the Commission. Also, please explain why the USPS does not include product specific costs in the mark-up base.

**Response:**

For the Mailing Online experiment, the Postal Service has projected that it will incur volume-variable costs and product specific costs. In the atypical circumstances of Mailing Online, the product specific costs are anticipated to be incurred primarily to provide a hardware and software system that will largely survive into the post-experimental period.

As suggested by the question, the Commission's preferred approach has been to define attributable costs as the sum of volume variable and product specific. Applying that approach here, all volume variable and product specific costs incurred during the experimental period would be identified, summed, and, after adding an appropriate markup, recovered from mailers through the rates and fees set for the experiment. Thus, the up-front costs of developing the system would fall exclusively on mailers during the experimental period. Such an approach precludes the option of evaluating the product's ability to recover those costs over a period which reflects the expected duration of the system, including the post-experiment period.

If placing the burden of recovering the up-front costs of system development entirely on the experiment increases the recommended price, it would greatly decrease the possibility of success and a later expansion of volume that would allow more

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OF THE OFFICE OF THE CONSUMER ADVOCATE**

gradual, but complete, recovery of all start-up costs. (Note that when a system is anticipated to be deployed in stages, rather than to be created all at once, a portion of start-up costs may continue to be incurred even after some parts of the system are in operation, without detracting from their status as start-up costs.)

Therefore, the Commission should take into account that the nature of the product specific costs involved in the Mailing Online experiment is not necessarily the same as the nature of more typical product specific costs. The product specific costs associated with the Postal Service's established services tend to be incurred on an ongoing basis. The Mailing Online product specific costs, on the other hand, are largely in the nature of start-up costs. In the future, if Mailing Online becomes an established service, it is expected to continue to incur some product specific costs, and those would over time become much more similar to the product specific costs for other established services. Until then, however, it seems to me more reasonable to acknowledge the important distinction between volume variable costs and product specific start-up costs.

In addition, our ability to estimate unit volume variable costs with some precision is much greater than our ability to estimate unit start-up costs with a similar degree of precision. This is because our ability to know the right level of volume to use as the denominator in deriving unit start-up costs is constrained by the nature of the service as an experiment, and the fact that it might be appropriate to include some post-experiment volumes.

Therefore, rather than ignore the distinction between volume variable and product specific costs, I have proposed a cost coverage of 130 percent (markup of 30 percent) over volume variable costs. (If a broader definition of attributable costs were

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used instead, I would propose a lower cost coverage, along the lines of OCA witness Collins's testimony in Docket No. MC98-1.) At the same time, of course, I have taken the product specific costs into account in my Exhibit D, when showing how the Postal Service envisions that the product specific costs will be covered. In this instance, at volume projected for the experiment, all costs of Mailing Online, including the product specific costs, will be recovered, and, additionally, an amount equal to 19.4 percent of total costs will be recovered as well. I confirm that, as suggested by the question, this amount represents the markup implicit in the Postal Service's Mailing Online proposal if the markup were to be calculated with reference to attributable costs as previously defined by the Commission for ongoing services. While this figure may be interpreted as a reason to worry less about the concern that attempting to recover all start-up costs during the experiment may be inappropriate, I believe it is necessary, with regard to a new product such as Mailing Online, to distinguish between volume variable and product specific start-up costs.

Finally, it should also be remembered that the mail pieces entered using Mailing Online provide additional contribution via their native subclasses, separate from their attributes as Mailing Online pieces. This provides an additional means of generating contribution that would be available to cover the costs of establishing the Mailing Online system.

DECLARATION

I, Michael K. Plunkett, declare under penalty of perjury that the foregoing answers are true and correct, to the best of my knowledge, information, and belief.

  
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Dated: 12/28/99

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS POELLNITZ TO  
PRESIDING OFFICER'S INFORMATION REQUEST NO. 1  
POIR No. 1, Question 2, p.1 of 1

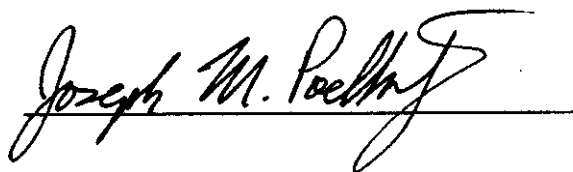
**QUESTION 2.** In USPS T-2, Table 6 on page 6, witness Poellnitz identifies the unit volume variable information technology cost as \$0.000638. Please confirm that \$0.000638 is the unit impression cost for Year 1 and that the average for the 3 year experiment period is \$0.000439.

**RESPONSE:**

Confirmed.

## DECLARATION

I, Joseph M. Poellnitz, declare under penalty of perjury that the foregoing answers are true and correct, to the best of my knowledge, information, and belief.

A handwritten signature in cursive script, reading "Joseph M. Poellnitz", is written over a horizontal line.

Dated: DECEMBER 28, 1999

**QUESTION 3.**

The Request of the United States Postal Service for a Recommended decision on an Experimental Classification and Fee Schedule for Mailing Online ("Request") states "the Postal Service plans to have its full network of 25 print sites in place near the middle of the second year of the experiment. While preparation of a request for a permanent service likely would not have to begin until soon after that time, much better data should be available than would be after only one year (when a permanent request to follow a two-year experiment might need to be ready)." Request at 3. Witness Garvey states "[s]ince preparation and completion of a case can take more than a year, a three year experiment can provide close to two years of experience with the service—including a full network of 25 printers—to consider whether a request for permanent service would be appropriate." USPS-T-1 at 12. Both statements infer that this will be a three-year experiment with the filing for a permanent change occurring at the end of the second year.

The Postal Service has proposed DMCS language pertaining to the duration of the experiment that appears in Section 981.61, Request, Attachment A at 5, and Fee Schedule 981, Request, Attachment B at 2. It states that the experiment will expire the later of:

- (a) three years after the implementation date specified by the Postal Service Board of Governors, or
- (b) if, by the expiration date specified in (a), a proposal to make Mailing Online permanent is pending before the Postal Rate Commission, the later of:
  - (1) three months after the Commission takes action on such proposal under section 3624 of Title 39, or
  - (2) —if applicable—on the implementation date for a permanent Mailing Online.

As stated, the proposed DMCS language allows the experiment to continue while a decision is pending before the Commission on a permanent request for Mailing Online, plus a possible additional three months. Thus, if the Postal Service does not file a permanent request until three years into the experiment, the experiment could conceivably continue for four or more years. The allowable duration proposed in the DMCS language appears to conflict with the request for a three year experiment as stated in the Request and in Witness Garvey's testimony.

- a. Please clarify the apparent conflict between the Request and Witness Garvey's testimony, and the proposed DMCS language concerning the duration of the experiment.



b. If the Mailing Online Experiment is meeting volume and pricing expectations at the end of two years, and is otherwise considered a success, please state any reason(s) why the Postal Service would not file a permanent request for Mailing Online at the end of two years.

c. If the Postal Service requests, and the Commission recommends, that Mailing Online Service rates and classification provisions no longer be experimental, please state any reason(s) implementation of permanent rates might be delayed more than three months beyond the Commission's decision.

**RESPONSE:**

The appearance of conflict arises from an attempt to fit the proposed DMCS language to the full range of possible outcomes and reflects recognition of problems encountered in, and lessons derived from, certain recent dockets. However, the subparts of this information request correctly anticipate expected Postal Service actions. The first of two lessons from the previous Mailing Online docket, MC98-1, was that the DMCS language affecting termination of the market test failed to anticipate the actual events that followed. See, e.g., October 26, 1999 letter to Margaret Crenshaw from William Johnstone (*announcing end of the market test and identifying affected DMCS language*). The second lesson was a more general one, that the Commission welcomed flexible application of its procedures to meet specific demands. The DMCS language proposed by the Postal Service constitutes an attempt to allow for the outer range of possible outcomes, while the quoted sections of the Request and Witness Garvey's testimony reflect the present intention of the Postal Service.

Also guiding the proposed DMCS language is the type of proceeding that might follow upon a successful Mailing Online experiment. The most likely and expected

outcome is a simple request for permanent authorization of Mailing Online. While such a case might prove to be a quick one, it is also possible that it could take the maximum ten months allowed by the Reorganization Act. Moreover, should it take that long, one might reasonably expect any resultant Opinion and Recommended Decision could require close consideration by management, and by the Governors; the history of past cases suggests that consideration could readily extend to a period of months.

A subsequent Mailing Online request could become part of an omnibus rate case.<sup>1</sup> If an omnibus case is being prepared for filing as the planned experiment draws closer to its planned three-year duration, it may be determined by postal management that resources would be utilized most efficiently by combining the filings. If this were the case, one could safely surmise that the requirements of Mailing Online would not dictate the actual schedule for an omnibus case, let alone any implementation date. The possibility that it might nonetheless be prudent and efficient to combine the two is why the theoretical limit on the duration of an experiment is actually longer than planned.

Recent experience with PRC Dockets MC99-1 and MC99-2 also provided significant guidance in fashioning the proposed DMCS language. There, the proximity of the filing date for Docket No. MC99-1 to a "hard-coded" DMCS termination date for the ongoing experiment caused Postal Service staff, management and Governors; and

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<sup>1</sup>While the Governors could also choose to seek another impermanent test if the experiment suggested that Mailing Online would be viable only if it were drastically restructured, that less likely eventuality was excluded from the DMCS language.

the Commission, to go to extraordinary lengths to avoid an interruption of service. In that situation, preparation of the Docket No. MC99-1 request for extension of the experiment and the MC99-2 request for permanent authorization required all involved to resolve both dockets with unusual and unprecedented dispatch. While the Commission should be lauded for its timely response to both requests, the Postal Service would prefer to learn from that experience rather than repeat it. Customer angst from terminating the Mailing Online market test also underlines the importance of avoiding a break in service.

The Postal Service recognizes that proposing DMCS language to reflect this range of possibilities is a novel approach. If Mailing Online proves successful, and its successor permanent form follows in a straight forward fashion from its experimental form, experiment managers will initiate the process of obtaining senior management's and the Board of Governors' approvals of a subsequent request two years into the experiment. Such a request would likely take several months to prepare, followed by several more months of Commission consideration. The hoped-for and planned result would thus be implementation of a permanent service by the end of three years; this plan is reflected in the Request and witness Garvey's testimony.

Also worth noting is that inherent in the Board of Governors' approval of the proposed DMCS language is a self-imposed limitation of the Board's discretion to determine an implementation date. As implicitly pointed out by subpart © of the information request, if the Governors choose to take more than three months to

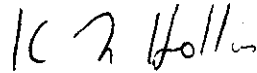
Response to POIR1, question 3, Docket No. MC2000-2

consider which statutory option to exercise on a Commission Opinion and Recommended Decision, they may also need to take responsibility for a break in service. The three month period is one within which the Governors have often acted on a favorable Commission recommendation in the past, but factors that might cause them to take more than three months cannot be anticipated at this time.

This response to Presiding Officer's Information Request No. 1, question 3, consists of legal argument and explanation. As such, it is offered as an institutional response rather than from a witness.

**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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December 28, 1999