

BEFORE THE
POSTAL RATE COMMISSION
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POSTAL RATE COMMISSION
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MAILING ONLINE EXPERIMENT

Docket No. MC2000-2

INITIAL BRIEF OF UNITED STATES POSTAL SERVICE

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INTRODUCTION

Summary of Mailing Online¹

Mailing Online unites the Internet's convenience and ease of use with traditional mail services. Mailing Online seeks to increase use of traditional hard copy mail by providing a convenient channel for submission and entry of mail in bulk by mailers who have not had access to discounted rates— whether they work in small offices, home offices (SOHO), or are mailing for personal purposes.

The design of Mailing Online is premised upon creation of mailpieces having inherently low processing costs. This is accomplished by capitalizing upon three key means of avoiding mail processing costs reflected by various existing discounts in the Domestic Mail Classification Schedule (DMCS): automation compatibility, presortation, and destination entry.

A Mailing Online customer uses the Internet to visit a web site, USPS.com, uploads a word processing document and a list of one or more addresses, and pays immediately online a sum certain that reflects a mark-up on commercial printers' charges and IT costs, plus the applicable postage. The Mailing Online system, which is scaled to accommodate up to 5000 simultaneous customers—appropriate for the volumes expected in a permanent version of the service—accepts jobs from all customers, commingles them, and distributes print stream batches in fully presorted form to geographically distributed printers around the country. Using digital printing technology, each printer converts electronic files into hard copy that is physically

¹ This summary is based on the full description of Mailing Online presented in the testimony of Lee Garvey, USPS-T-1.

entered into the mail the following business day at a postal facility where the mailpieces can be distributed locally. In its fully mature form, Mailing Online will verify and correct address hygiene and check for the potential existence of an applicable forwarding order.

Background to and Purpose of this Proceeding

The instant Request by the Postal Service for authorization to conduct a three-year experiment pursuant to 39 C.F.R. §§ 3001.67 - 67d was filed on November 16, 1999. The Postal Service proposes in this docket an experiment to roll out Mailing Online, and permit the collection of information that will support a later request for permanent Mailing Online.

The Postal Service previously conducted a market test of Mailing Online, pursuant to the Commission's Opinion and Recommended Decision in Docket No. MC98-1 and the Board of Governors' acceptance.² Docket No. MC98-1 also involved a request for authorization to conduct a Mailing Online experiment which was subsequently withdrawn.³ The withdrawal was occasioned by a decision to provide Mailing Online via a different Internet platform, which would result in changes in the cost

² Postal Rate Commission Opinion and Recommended Decision, Docket No. MC98-1 (October 7, 1998); Decision of the Governors of the United States Postal Service on the Recommended Decision of the Postal Rate Commission on the Market Test of Mailing Online Service, Docket No. MC98-1 (October 16, 1998), implemented via Resolution No. 98-13. The experiment began on October 30, 1998.

³ The withdrawal was authorized by the Board of Governors in Resolution No. 99-5 (May 3, 1999). A copy of the Resolution was filed as an attachment to the Notice of United States Postal Service of Withdrawal of a Request for a Recommended Decision and Motion to Close Docket (May 5, 1999).

estimates underlying the original request.⁴ The Postal Service informed the Commission that a subsequent request for authorization to conduct a Mailing Online experiment could be expected.⁵ The Request in the instant docket constitutes that subsequent request.

The proposed Mailing Online experiment is intended to provide for the ramp up of the service from its earlier market test phase,⁶ in which the supporting system would not allow many simultaneous users, to a scalable, nationwide, permanent service. The experiment is intended to provide Mailing Online to customers via the same hardware and software components that a permanent Mailing Online would also use. The Postal Service hopes to gain experience with operating the system while volume builds, with the intent of using information derived from the experiment to support a request for permanent Mailing Online. A permanent service would then succeed the experiment with no break in service.

⁴ Notice of United States Postal Service of Withdrawal of a Request for a Recommended Decision and Motion to Close Docket (May 5, 1999).

⁵ *Id.*

⁶ On October 29, 1999, a year after the market test began, it was concluded—to the chagrin of its successful users. See October 26, 1999 letter of Postal Service Managing Counsel William T. Johnstone to Postal Rate Commission announcing market test cessation.

I. THE POSTAL SERVICE'S UNREBUTTED DIRECT CASE PROVIDES FULL SUPPORT FOR THE REQUESTED EXPERIMENT

The Postal Service's direct case rests on six pieces of testimony. The direct testimony of witness Garvey, USPS-T-1, provides the policy, operational and business objectives to which Mailing Online responds.⁷ *Id.* at 1. He concludes:

Mailing Online constitutes a critical effort to modernize the Postal Service and combine more modern communications methods with its traditional role of collecting and delivering hard copy messages. Adaptation to the increasingly rapid changes in today's technology can only be categorized as crucial to the future of the Postal Service. This proposal for a Mailing Online experiment embodies the synergy of lessons of the past with the promise of the future.

Id. at 20.

Witness Poellnitz, USPS-T-2, provides an overview of all the cost components of Mailing Online service over the projected three-year experiment. *Id.* at 1. His testimony provides specific estimates of costs incurred by print contractors. *Id.* He also estimates advertising costs and characterizes witness Lim's (USPS-T-3) information technology (IT) costs per the definitions of product specific and volume variable provided by witness Takis, USPS-T-4. Exhibit USPS-2A.

Witness Lim, USPS-T-3, a highly experienced Internet development consultant, provides detailed IT cost estimates for the duration of the three-year experiment. He explains how the Mailing Online systems works and provides specific details about the

⁷ When witness Garvey left the employment of the Postal Service, his testimony and cross-examination were adopted by witness Plunkett, who also sponsors testimony designated as USPS-T-5. See Notice of United States Postal Service Regarding Substitution of Witness (January 3, 2000). Witness Plunkett also was cross-examined orally on USPS-T-1. Tr. 2/144-278.

function and costs of each system component, where each is located, and when costs are incurred. USPS-T-3 at 11.

Witness Takis, USPS-T-4, explains how and why the Commission and the Postal Service apply the principles of cost causality to allocate costs from a shared infrastructure such as USPS.com to specific, supported products such as Mailing Online. *Id.* at 30-31.

Witness Plunkett, USPS-T-5, addresses the three essential components reflected in the proposed payments by Mailing Online customers. These three components are the premailing costs borne by contract printers and charged back to the Postal Service, an IT cost that reflects the cost of building and running the Mailing Online system, and postage for each piece of mail. Witness Plunkett proposes a mark-up of 30 percent on the sum of the contractor's price to the Postal Service plus \$.001 per impression based on volume variable IT costs, plus the Automation Basic postage for First-Class Mail, Priority Mail, Express Mail, or Standard Mail, as appropriate. *Id.* at 5-6. Witness Plunkett does not quantify, as part of the pricing of Mailing Online, either the contribution inherent in the applicable postage rates or the cost avoidance inherent in the characteristics of Mailing Online pieces. *Id.* at 9. He does show that his proposed fee would cover all Mailing Online costs, including product specific costs, and make an additional contribution to the other costs of the Postal Service. Exhibit USPS-5D, as revised at Tr. 3/505.

The analyses of witnesses Poellnitz and Plunkett both depend on the volume projections presented by witness Rothschild in her testimony in Docket No. MC98-1

(USPS-T-4). The Postal Service included with its direct case a motion,⁸ subsequently granted,⁹ to include witness Rothschild's testimony as record evidence in this docket. Witness Rothschild's testimony thereby constitutes the sixth piece of direct testimony relied upon by the Postal Service in this docket. Witness Rothschild had directed the market research that originally informed the Postal Service judgment regarding development of Mailing Online. When a decision was first made to bring Mailing Online to the Commission, she documented the sources and methods used to develop her market research data, for presentation in Docket No. MC98-1.

No party in this case presented evidence rebutting the Postal Service's testimony,¹⁰ although parties have designated evidence from Docket No. MC98-1 which they may cite in support of arguments that the Commission's recommended decision should differ from that urged by the Postal Service in one or more respects. Accordingly, following hearings on the Postal Service's direct case, the next major procedural milestone in this case is the filing of initial briefs.

⁸ Motion for Designation of Testimony and Cross Examination from Previous Docket as Evidence in Commission Docket No. MC2000-2 (November 16, 1999).

⁹ Presiding Officer's Ruling No. MC2000-2/4.

¹⁰ The file testimony of witness Callow on behalf of the Office of the Consumer Advocate, OCA-T-100, was withdrawn by the OCA as a result of the Stipulation and Agreement regarding the eligibility of services offered by private firms—and deemed functionally equivalent to Mailing Online—to applicable discounted postage rates on the same basis as Mailing Online. The Stipulation and Agreement is discussed more fully below in section IV.C.1.

II. THE POSTAL SERVICE PRESENTS COMPREHENSIVE AND CONSERVATIVE COST ESTIMATES IN SUPPORT OF ITS FEE PROPOSAL

Witness Lim estimates the Postal Service's information technology (IT) costs for the Mailing Online experiment. USPS-T-3. His comprehensive estimates include systems development and implementation, administrative management and maintenance, help desk, and print site costs. USPS-T-3, Workpapers A through D. Each of these areas is analyzed in terms of hardware, software, personnel, telecommunications and networking, and services. Witness Lim also divides his results into those that are concluded before the experiment is to begin, and those that occur once the experiment begins, by year. USPS-T-3, Workpaper E. Witness Lim excludes general IT costs that are not caused by Mailing Online. USPS-T-3 at 9. However, Mailing Online in most regards is designed as a stand-alone product, and is costed accordingly. *Id.* at 7.

Based on witness Lim's IT cost estimates and witness Takis' definitions of product specific and volume variable costs, witness Poellnitz determines the product specific and volume variable IT costs. Most of the IT costs are product specific. Exhibit USPS-2A, at 2.

Witness Poellnitz also estimates the Postal Service's premailing costs for Mailing Online. USPS-T-2. Most of these costs are incurred directly by a printer, to be paid by the Postal Service as provided by contract. These costs consist of costs incurred for each impression, as well as inserter, transportation, paper, and envelope costs. *Id.* at 5-14. For pricing purposes, these printer cost estimates will be superseded by the actual prices included in the printer contracts. However, they provide a reasonable

estimate of printer costs to be incurred during the experiment. Finally, witness Poellnitz estimates advertising costs for Mailing Online. *Id.* at 15.

Both witnesses Lim and Poellnitz use conservative assumptions to avoid understating their cost results. USPS-T-2 at 7, 11, 12; Tr. 2/56 (Poellnitz); USPS-T-3 at 1; Tr. 3/363, 365, 370, 378, 380, 408-09 (Lim). Thus, even if one were to identify some additional Postal Service costs to be recovered during the experiment, or suggest different volumes for the experiment—which no participant has done—witnesses Lim's and Poellnitz's costs would likely still provide an appropriate estimate of total costs for the Mailing Online experiment.¹¹

¹¹ Certain costs are shared among Mailing Online and other parts of USPS.com, such as payment and registration costs. These costs would be incurred even if Mailing Online were unavailable, because other USPS.com products and services require payment and registration. USPS-T-3 at 4-5. Nonetheless, even if payment and registration costs were allocated to Mailing Online, the additional cost would be trivial. Tr. 3/425.

III. THE POSTAL SERVICE'S COST ESTIMATES ARE GROUNDED IN SOUND ECONOMIC THEORY

A. Cost Estimates Should Be Based Firmly on Cost Causality

Witness Takis presents the conceptual basis for costing of the Mailing Online product, and emphasizes the importance of ensuring that the methodology used to develop product costs is economically sound. USPS-T-4. The fundamental basis of any cost allocation mechanism is the principle of cost causality grounded in an understanding of underlying operational realities. *Id.* at 4. Both the Postal Service and the Commission have historically held that costs should be allocated to individual products and groups of products on a causal basis.¹² *Id.* at 5. Witnesses Poellnitz and Lim apply these sound theoretical costing principles in their development and allocation of Mailing Online printing, advertising, and information technology costs.

Witness Takis cautions against a number of costing pitfalls that can result in inaccurate product costs and subsequent improper pricing. *Id.* at 11. He illustrates the "correlation trap" that can arise if an analyst equates correlation with causation when developing volume related or product specific costs. *Id.* at 12. The notion that a particular cost benefits a product is not necessarily equivalent to the notion that the product causes the cost to accrue. *Id.* at 12. Witness Takis examines the problems associated with fully distributed cost (FDC) approaches, which often distribute costs based on correlation analyses rather than operationally-based causation analyses. *Id.* at 13. The problem with choosing an allocation factor for common costs is that no

¹² For a Commission discussion of causation as the principle of cost attribution, see Docket No. R90-1, PRC Op., Vol. 1, at III-210.

cause and effect relationship exists between individual products and a pool of common costs. If a causal relationship to individual products existed, these costs would not be classified as common. Witness Takis shows how the product costs resulting from FDC mechanisms can vary widely depending on the selected allocation method. *Id.* at 16. To allocate to products common costs such as the costs of the USPS.com infrastructure would violate sound economic costing theory and past Commission precedent.¹³ Witnesses Poellnitz and Lim have avoided FDC approaches and costing pitfalls associated with other methods not based on causality.

Witness Takis applies this principle of cost causality to the problem of product cost development in a shared infrastructure environment. *Id.* at 19. The USPS.com channel is an example of a shared infrastructure environment, which serves many different products, of which Mailing Online is one.¹⁴ USPS.com, like the retail channel,

¹³ Both the Commission and the Postal Service have long recognized the serious problems associated with FDC approaches, and have consistently stated their disapproval for such methodologies (e.g., PRC Op., R87-1, Vol. 2, Appendix J, CS IX, at 9). The Commission has shown its discomfort with FDC approaches for many years. In PRC Op., R74-1, the Commission stated:

In the prior case, we expressed statutory reservations regarding a fully distributed costing method under which costs are first assigned to the classes and services on the basis of causation, and the remainder mathematically apportioned on a uniform basis. See PRC Op. 1-280, n. 1. We now believe those reservations were well taken; and that fully distributed costs, as defined above, would not satisfy the standards of § 3622. We reject a fully distributed costing method here in favor of the concepts of variability and demand discussed throughout this opinion.

PRC Op., R74-1, Vol. 1, p.124.

¹⁴ Compared to the previously proposed experiment, however, the experimental Mailing Online system is "more of a self-functioning system and less dependent on the
(continued...)

can be thought of as a means by which a number of different products and services are provided to Postal Service customers. *Id.* at 20.

Witness Takis illustrates how various types of costs in a shared infrastructure environment should be allocated to individual products and services on a causal basis. *Id.* at 21. Costs that are caused by individual products but are neither part of the shared infrastructure/channel nor of any other product should be allocated to the specific product that causes them. *Id.* at 21. Examples of such costs include the Mailing Online printing costs that are developed by Witness Poellnitz and allocated to Mailing Online accordingly.

Costs may exist which are technically part of the shared infrastructure/channel but are caused by specific products, and therefore should be allocated to individual products. *Id.* at 22. Examples of such costs include the portion of the help desk and T3 line Internet connection costs caused by Mailing Online. *Id.* at 22.

Finally, some costs are part of the shared infrastructure/channel but are not caused by any particular product sold through the channel. In economic costing terms, these costs are considered "fixed and common" and are not allocable to any particular product because they are not caused by any particular product. Instead, they are covered by all products sold through the channel in their respective markups over cost. *Id.* at 22. The costs of the USPS.com infrastructure, including its registration and payment systems, are not caused by any particular product and therefore should not be allocated to individual products.

¹⁴ (...continued)
USPS.com system." USPS-T-3, at 7.

All costs of the shared infrastructure environment are recovered if costs are allocated on a causal basis. Volume-related and product specific costs (costs caused by individual products, whether or not related to a shared infrastructure) are recovered by individual products. Unallocable costs (fixed and common costs not caused by any particular product) are recovered by markups on all products. *Id.* at 27. In applying the costing principles identified by witness Takis, witnesses Poellnitz and Lim have provided the foundation for appropriate cost recovery. Witness Plunkett also applies the principles discussed by witness Takis to ensure that all costs are recovered by his fee proposal. USPS-T-4, at 27-29; USPS-T-5, at 5-7.

B. Some of the Costs Incurred Prior to the Experimental Period Are Not Relevant to Mailing Online Experimental Fees

Witness Lim explains that the Mailing Online system developed for the period of the experiment will be an entirely new system distinct from prior versions of Mailing Online. The equipment used during the period of the experiment will entirely replace the software and hardware that were used for the market test. Tr. 3/429. The new scalable system will meet the requirements of a national rollout, unlike previous versions that were not suited for such use, but instead served as a proof of concept. As witness Plunkett describes, the Mailing Online market test is in many ways a fundamentally different product from previous versions of Mailing Online. Costs associated with the market or operations tests of Mailing Online are more akin to research and development costs intended to collect information for use in developing the Mailing Online experiment. Tr. 3/486.

Significantly, Mailing Online is different from some other new products because its utility is tied directly to the Postal Service's core mail products (e.g., First-Class Mail and Standard Mail); its purpose is to provide a new channel for access to those products. The fundamental principle behind Mailing Online is that it creates a convenient means for customers to use the Postal Service's largest existing products. Tr. 3/484-485. As such, any costs that the Postal Service has incurred in developing previous versions of Mailing Online are costs that were incurred to make it easier for customers to use its core products, which contribute significantly to the overall costs of the Postal Service. Tr. 3/485.

If Mailing Online had been profitable during its previous testing, one would not deduct such profits from the cost of the experiment in designing fees for the experiment. Rather, the Postal Service would identify all of the relevant costs during the experiment and set fees so as to recover all those costs and make a contribution to institutional costs during the experiment. Tr. 3/498. Similarly, the Postal Service properly does not include in the experimental cost base those costs incurred for prior versions of Mailing Online, especially when Mailing Online during the experiment will be a "completely new system" that does not make use of hardware or software from the previous versions. Tr. 3/429-32.

C. Product Specific Costs Should Be Excluded from the Cost Base Used for Markups

The product specific costs that are projected for development of Mailing Online will primarily serve to provide a hardware and software system that is expected to survive beyond the period of the experiment and into the permanent service. Tr. 3/455.

Placing the burden of recovering the up-front product specific costs of system development entirely on the experimental period could be counter-productive. Attempting to recover all start-up costs in the experimental period would result in higher recommended fees for the experiment. Higher fees would inhibit demand for Mailing Online and therefore decrease the likelihood of its success. This could, in turn, prevent the recovery of start-up costs. Tr. 3/455-456.

The nature of Mailing Online's product specific costs is different from that of typical product specific costs since they generally will not be incurred on an ongoing basis and will not recur. Until Mailing Online becomes an established service exhibiting typical recurring product specific costs, it is important to distinguish between product specific start-up costs and volume variable costs. Tr. 3/456.

The Postal Service has proposed a cost coverage of 130 percent over volume variable costs, in part based on the exclusion of product specific costs from the cost base. A lower cost coverage would be appropriate if a broader definition of attributable costs were applied. Tr. 3/457. At the same time, witness Plunkett has taken product specific costs into account in an incremental cost test, showing that they would be recovered during the experiment through the markup over volume variable costs. Tr. 3/457. The Mailing Online fees would also make a direct contribution and generate additional indirect contribution by increasing the use of the underlying subclasses of mail. Tr. 3/457; Exhibits USPS-5D, as revised at Tr. 3/505, and USPS-5F; Docket No. MC98-1, USPS-T-4, at 33. In this regard, the inherently low mail processing costs for Mailing Online pieces should increase contribution.

The Postal Service has historically defended the position that marginal costs should form the basis for rational rate-setting, and incremental costs should be used to evaluate rates for cross-subsidy. Docket No. R97-1, USPS-T-11, at 6-11.¹⁵

Furthermore, incremental costs should not form the basis for markups required to satisfy the break-even constraint. Docket No. R97-1, USPS-T-11, at 28-30. Mailing Online provides the most compelling case to date for this economically sensible approach, given the start-up nature of Mailing Online product specific costs. The Postal Service's exclusion of product specific costs from the cost base used for markups is an economically sound position that still allows full recovery of Mailing Online costs during the experiment.

¹⁵ See also Docket No. 2000-1, Direct Testimony of Virginia Mayes, USPS-T-32, at 16-18.

IV. THE POSTAL SERVICE'S PROPOSAL IS CONSISTENT WITH THE APPLICABLE PRICING AND CLASSIFICATION POLICIES OF THE ACT

A. Mailing Online Is Consistent with the Classification Criteria

Mailing Online fulfills the Postal Service's general mandate to provide its customers with access to convenient and economical postal services. 39 U.S.C. §§ 101, 403, 3623(c). By enabling customers to upload documents and address lists through the Postal Service's web site, Mailing Online greatly reduces the time and effort required for customers to send mail. It would make available rate categories offering discounts to customers who are not currently able to take advantage of reduced rates. Mailing Online would therefore contribute to the fairness and equity of the classification system in accordance with § 3623(c)(1). It would enhance the value of current services and make available a highly desirable means for the production and entry of mail using a highly desirable new special service in accordance with § 3623(c)(2) and (5). Moreover, Mailing Online holds the potential to reduce the cost and improve the speed of postal services for small and medium sized businesses and individual customers, in accordance with the considerations of § 3623(c)(3). USPS-T-5, at 12-14.

B. The Pricing Structure Is Fair and Consistent with the Act

The pricing structure proposed by the Postal Service, whereby a set markup is applied to printer costs which vary by location, is fair and consistent with the Act. In Docket No. MC98-1, the Commission affirmed the propriety of the Postal Service's approach as fair and likely to lower the probability that Mailing Online would not cover its costs. Docket No. MC98-1, PRC Op. at 33.

1. A markup based system simplifies what would otherwise be a complicated fee schedule.

The chief advantage offered by the digital printing technology used by Mailing Online printers is its flexibility. Relative to offset printing, digital technology allows for multiple documents to be incorporated into a single job. In order to provide Mailing Online customers the advantages that this flexibility affords, the Mailing Online will offer an array of printing options. One consequence of this is a fee structure that is, by necessity, complicated. Though computers make management of almost any number of fees theoretically possible, simplification is nevertheless desirable because it reduces the administrative effort required to manage the system and facilitates communication of product features and prices to the customer. A markup that is applied uniformly to printing elements, as has been proposed by the Postal Service and recommended by the Commission for the market test, reduces complexity in pricing while allowing customers access to a wide range of printing options. USPS-T-5, at 4; Tr. 2/120.

2. A markup based system allows Mailing Online customers to benefit more readily from changes in technology.

The technology and features that support Mailing Online are expected to change often and rapidly. Thus, the markup based pricing system proposed in this docket allows the flexibility necessary to ensure Mailing Online can adapt to such changes and meet customer expectations. New features can easily be inserted into the Mailing Online menu of printing options at the existing markup rate without the need to seek approval for new fees. USPS-T-5, at 3. Mailing Online software will be on a rolling development schedule with new versions scheduled for release several times a year. A pricing system that required Commission approval to offer new features would result

either in continuous litigation or in delayed implementation of product enhancements to the detriment of Mailing Online customers. Docket No. MC98-1, USPS-T-5, at 4.

3. A markup based pricing system will make Mailing Online's cost coverage more stable

Moreover, cost changes, whether driven by technological change or in fluctuations in the cost of materials, will neither erode nor inflate Mailing Online's cost coverage. Because most Mailing Online costs are specified in contracts, they are expected to remain relatively stable on a per-unit basis. Through use of a markup, when changes do occur, prices are immediately adjusted. Therefore, customers are able to benefit from technological changes that result in lower costs. Similarly, when cost increases affect Mailing Online, prices are automatically adjusted upward to preserve the product's cost coverage. Docket No. MC98-1, USPS-T-5, at 4.

C. The Use of Automation Basic Rates for First-Class Mail and Standard Mail Pieces Is Appropriate

As indicated in the testimony of witness Garvey, Mailing Online has been designed to drive postal costs out of the system. USPS-T-1, at 16. Mailing Online pieces are automation compatible, utilize the FASTforward system, and the software that manages Mailing Online documents has been designed to enable presortation to levels finer than would often be used by typical commercial presortation packages.¹⁶ In addition, the Mailing Online printing network has been designed to allow for entry of mail at or near the point of destination, thus avoiding transportation and origination

¹⁶ Mailing Online mailings are always presorted in walk sequence order, irrespective of the rate for which a mailing would otherwise qualify. See Response of Witness Plunkett to Questions Raised at Hearings, filed January 19, 2000.

handling costs. For these reasons Mailing Online pieces are expected to be considerably less costly to handle than otherwise comparable pieces. It is therefore reasonable to offer customers a set of rates that reflects the cost saving features built into Mailing Online. While the experiment offers an opportunity to collect data on depth of presort, the Postal Service's believes that automation basic rates are an appropriate proxy for use during the experiment. USPS-T-5, at 8.

1. Customers of Mailing Online and functionally equivalent services should be given an exception from existing volume minimums.

Though Mailing Online pieces are in all other ways eligible for automation basic discounts, the Postal Service has requested that Mailing Online customers be granted an exception to the minimum volume requirements that would otherwise apply. The Postal Service's volume projections clearly indicate that at projected volumes, Mailing Online mailings will, on average, far exceed the volumes necessary to qualify for the proposed rates. USPS-T-5, at 10-11. On occasion, however, and especially near the beginning of the experiment, individual mailings in particular locations might not meet the otherwise applicable minimums. There is no practicable alternative to making such mailings eligible for the automatic basic rates. Instead, the Postal Service is proposing that the same exception be granted to services offered by private firms which are functionally equivalent to Mailing Online. The two parties who expressed most concern about the availability of the exception in this case and in the market test have agreed to the Postal Service's functional equivalency solution. This agreement is set forth in the Stipulation and Agreement filed on February 24, signed by the Postal Service, Pitney Bowes, the Office of the Consumer Advocate, and Douglas F. Carlson. The DMCS

language agreed to by these parties and attached to the Stipulation and Agreement would provide the same exception as is proposed for Mailing Online to functionally equivalent services which also forgo a claim on deeper discounts in exchange for blanket eligibility for automation basic rates.

2. Use of uniform postage rates is consistent with the Postal Service's approach to pricing of production services.

Use of a uniform rate for all pieces within a subclass comports well with the flat rate pricing that will apply to printing services. One of the economic features of digital printing is that unit costs do not vary greatly with quantity, unlike traditional printing, for which unit costs drop substantially as unit costs increase. Customers who would be mailing in quantities greater than 5000 pieces therefore are not likely to make economic use of digital printing for their documents. Tr. 2/85 The Postal Service believes that the application of postage rates that were designed to provide incentives for greater quantities and greater levels of worksharing runs counter to the goals of Mailing Online.

- D. The Cost Coverage Proposed for the Experiment Is Consistent with the Criteria of the Act

During the market test of Mailing Online, customers paid fees that were 125 percent of contract printer costs plus a 0.1 cent per impression charge intended to offset information technology costs. As explained in the testimony of witness Plunkett (USPS-T-5), the proposal in this docket is largely the same, although the Postal Service has proposed that customers pay 130 percent of contract printer costs plus the 0.1 cent per impression charge (USPS-T-5, at 15).

1. The proposed cost coverage is designed to cover attributable costs.

As indicated above, the markup system proposed by the Postal Service, because it allows revenues to be adjusted to reflect printing cost changes, reduces the likelihood that adverse cost impacts will affect the contribution made by Mailing Online. Moreover, because the unit volume variable information technology costs which the 0.1 cent per impression charge is designed to recover are significantly less than 0.1 cent, this charge will also more than cover attributable costs.¹⁷ As indicated in witness Plunkett's testimony, Mailing Online will generate sufficient revenues during the experiment to cover all incremental costs and make a substantial contribution to the other costs of the Postal Service. Exhibit USPS-5D, as revised at Tr. 3/505.

2. The proposed cost coverage meets the judgmental criteria.

Mailing Online would enhance fairness and equity and the value of mail service. It would have a positive effect on underserved postal customers and would not disadvantage alternative service providers. As currently structured, the Postal Service's discount structure requires customers to undertake preparation activities, and to present volumes in specified quantities, in order to receive access to discounted rates. As a result, some segment of the Postal Service customer base does not qualify for discounted rates, which has negative cost implications for the mailer and for the Postal Service: The mailer is unable to obtain discounted rates, and the Postal Service handles mail that in many cases may be unnecessarily costly. While many businesses

¹⁷ Witness Poellnitz testified that the unit volume variable information technology cost is 0.0638 cents for the first year of the experiment and 0.0439 cents for the three-year period. Tr. 2/67

utilize the services of presort bureaus and mailing houses to prepare their mailings, the Postal Service's research indicates that many mailers sending fewer than several thousand pieces per mailing are unlikely to be in the market for such services.

The proposed cost coverage is fair and equitable in comparison to other special services. Many special services have cost coverages that are below the system-wide average. This is in part because these special services indirectly provide additional contribution to the Postal Service's institutional costs by enhancing the products with which they are associated. Similarly, by making First-Class Mail and Standard Mail A more convenient, Mailing Online is expected to foster greater use of both services and thereby to make a significant indirect contribution to the Postal Service's institutional costs.

The Postal Service believes a Mailing Online experiment will not create any adverse impact on competition. Because Mailing Online is designed to meet needs of smaller customers who are underserved today, Mailing Online would not harm private firms. Moreover, the record shows that Mailing Online may increase the overall market for hybrid electronic postal services and lettershops. Docket No. MC98-1, USPS-T-1, at 12-14; Tr. 2/151. Thus, competition can be expected to thrive as the market expands.

In proposing Mailing Online, the Postal Service is not seeking to "engage in activities traditionally performed by the private sector," contrary to the assertions of Pitney Bowes and MASA in Docket No. MC98-1. PB Brief at 3; MASA Brief at 6. All printing and finishing services will be provided by private contractors. The integration function that the Postal Service fills cannot be described as traditionally performed by any entity or group. And if the Commission recommends the DMCS language

concerning functionally equivalency attached to the Stipulation and Agreement, companies that develop functionally equivalent services will be able to have access to the same postage rates as Mailing Online, removing any arguable advantage to the Postal Service in its original proposal.

In the previous Mailing Online docket, both Pitney Bowes and MASA relied on arguments based on the E-COM cases. Docket No. MC98-1, PB Brief at 2; MASA Brief at 6. In contrast to E-COM, Mailing Online was specifically designed so that the Postal Service would not be entering into activities performed by the private sector. The Postal Service is not entering into the printing or telecommunications businesses; instead, it is relying on private printers, who can participate by competing for contracts, and on existing telecommunications infrastructure in the form of the Internet.¹⁸

As noted above, the degree of mail preparation is a cornerstone of the Mailing Online fee and rate structure. Also, as previously noted, the proposed fee is simple and its relationship to other rates and fees is clear.

3. Witness Rothschild's volume projections are an appropriate basis for evaluating the financial impact of Mailing Online during the experiment.

Witness Rothschild's volume estimates were based on a number of assumptions and estimates. The Postal Service believes that witness Rothschild's work is still an

¹⁸ Unlike the circumstances that triggered concern in the Provisional Packaging Service case, the Postal Service is proposing to enter a market serving small mailers not currently served by the private sector. See PRC Op., MC97-5, Dissenting Opinion of Commissioner LeBlanc at 1. As in that case, moreover, there is "insufficient evidence to justify a conclusion that the probable impact of introducing" Mailing Online on the private sector "is likely to be undue, unreasonable or unnecessary." PRC Op., MC97-5, at 41.

appropriate basis for volume and revenue projections for Mailing Online. In some ways, witness Rothschild's estimates now look even more conservative. As pointed out by witness Plunkett, Internet use, a factor used by witness Rothschild in her analysis, has increased dramatically in the last several years. Tr. 2/129. In addition, during the proposed experiment, Mailing Online will offer a number of enhanced features, e.g. full color printing and non-profit rates, that were not contemplated when witness Rothschild conducted her research. Tr. 2/96.

V. THE EXPERIMENTAL DATA COLLECTION PLAN WILL PROVIDE INFORMATION SUFFICIENT TO GAUGE THE SUCCESS OF THE EXPERIMENT

The Postal Service plan for data collection (Appendix A to USPS-T-1) will be useful both in informing the Commission in its evaluation of the success of the experiment, and in informing the Postal Service whether to propose a permanent classification for Mailing Online. The Postal Service believes that the type and scope of information proposed to be collected is sufficient to allow for such further evaluation. The Postal Service examined the needs for information in light of the ability to provide it, and the experience in the Mailing Online market test to arrive at its data collection plan.

In the data collection plan, the Postal Service proposes largely to continue with data collection as it was performed for the market test. *See also*, Tr. 2/102-04. However, the frequency of the reports will now be on a semiannual basis, and in a more consolidated format. *See also* Tr. 2/249-54.

The Postal Service's data collection focus during the experiment will be on three main areas: use, operations, and costs. The categories of data to be collected during the experimental period include revenues, costs, and volumes by printing category and class of mail. Information that appears on postage statements will be available for analysis. Tr. 2/154-56. Additionally, the Postal Service plans to collect and report any costs associated with preparing advertising or promotional materials associated with Mailing Online during the experimental data collection plan. Tr. 2/101; Tr. 2/215-19.

During the market test, more frequent reports were needed to inform the Commission's ongoing consideration of the Mailing Online experiment. No comparable

need now exists; therefore, by consolidating information over a longer time frame, each semiannual report can provide the same information that in the market test was spread across 44 separate reports. Semiannual reports will reduce unnecessary paper flow, while still providing regular and up-to-date information on the progress of the experiment, satisfying the Commission's needs for timely and accurate information.

CONCLUSION

For the reasons stated above, the experimental changes in the Domestic Mail Classification Schedule and fees proposed by the United States Postal Service, as supplemented by the Attachment to the Stipulation and Agreement filed on February 24, 2000, are supported by the evidentiary record and are in accord with the applicable provisions of the Postal Reorganization Act.

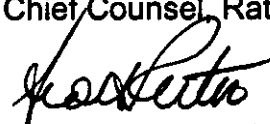
WHEREFORE, the Postal Service requests that the Postal Rate Commission recommend under 39 U.S.C. § 3624(d) the Mailing Online experiment.

Respectfully submitted,

UNITED STATES POSTAL SERVICE

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March 15, 2000

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.

A handwritten signature in black ink, appearing to read "Scott L. Reiter", is written over a horizontal line.

Scott L. Reiter

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March 15, 2000