

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

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POSTAL RATE COMMISSION  
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MAILING ONLINE EXPERIMENT

Docket No. MC2000-2

REPLY BRIEF OF  
MAIL ADVERTISING SERVICE ASSOCIATION INTERNATIONAL  
AND PRINTIMAGE INTERNATIONAL

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Date: March 27, 2000

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Mail Advertising Service Association International (“MASA”), and PrintImage International (“PII”) file this reply brief setting forth their response to the Postal Service’s initial brief filed in this docket in support of its request for a recommended decision approving the experimental offering of Mailing Online (“MOL”).

**INTRODUCTION**

The Postal Service and the Office of Consumer Advocate (“OCA”) are the only parties other than MASA and PII to have filed initial briefs in this matter. The Postal Service and the OCA each support the offering of MOL on an experimental basis, and each takes comfort that the “functional equivalence” stipulation has addressed the competitive considerations presented by the Postal Service’s proposed entry into competition with private business. Indeed, the Postal Service goes farther and denies that MOL competes at all with private mail preparation firms and small printers. As discussed below, and elaborated on at length in the MASA/PII initial brief, the Postal Service position on competition is wrong.

Not surprisingly, the Postal Service adheres to its position on costing, arguing in its initial brief that product specific costs, start-up costs, and advertising costs are not attributable and should not be part of the cost base that is marked up to price MOL. The OCA argues that

product specific costs and advertising costs are attributable and should be marked up under long-standing Commission precedent and suggests that the IT portion of the MOL fee should be increased to \$.005 from the \$.001 proposed by the Postal Service. MASA and PII agree with the OCA that these costs are improperly excluded from the Postal Service's calculation of the attributable cost base. MASA and PII go further, however, and request that the Commission also attribute the so-called pre-experiment costs of MOL incurred prior to the commencement of the experimental period in connection with the Market Test. The OCA did not address these costs in its initial brief.

Finally, MASA and PII request in this reply brief certain limited modifications to the Postal Service's proposed data collection plan.

**I. THE POSTAL SERVICE DOES NOT GIVE PROPER WEIGHT TO THE IMPACT OF MOL ON MAIL PREPARATION AND PRINTING FIRMS**

The Postal Service argues in its initial brief that MOL "will not create any adverse impact on competition." Initial Brief of United States Postal Service ("USPS Br.") at 22. The Postal Service is wrong on this point and its contention is unsupported in the record and ignores the contrary evidence.

First, the Postal Service argues that MOL will not harm private firms because it is designed to attract "smaller customers who are underserved today." *Id.* While the Postal Service has argued that it is seeking to attract the SOHO market, with mailings of 5000 pieces or under, there are several factors that undermine the conclusion it draws that, therefore, no private firms will suffer competitive injury. First, there is nothing inherent about the MOL offering that limits it to mailings of 5000 pieces or less. While there may be more economical ways of printing mailings that are larger than 5000 pieces, these methods do not afford the same printing

flexibility and personalization that digital printing affords. For mailers who are seeking these features, the lower cost alternative of offset printing is not available.

Second, the evidence in the record – which is entirely ignored in the Postal Service’s initial brief – is that a substantial portion of the mail preparation industry depends on business from the supposedly underserved SOHO market. As MASA witnesses Schuh and Jurgena testified, between 60% and 65% of their business comes from mailings under 5000 pieces. Tr. 825-26; 850-51. Witness Schuh’s survey of other members of the mail preparation industry concluded that 58% of the survey group’s business came from such mailings. Witness Schuh testified that even if only 62% of the MOL business came from existing users of the mail, as the Postal Service contends it will, mail preparation firms serving this market will lose a substantial part of their business. Tr. 825-26. This evidence stands unrebutted in the record.

The Postal Service also denies MASA’s contention that it is seeking to engage in activities traditionally performed by the private sector, relying on two erroneous contentions to support its position. First, it claims that the “integration function” that it performs under MOL “cannot be described as traditionally performed by any entity or group.” USPS Br. At 22. Whatever significance this cryptic assertion may have to the Postal Service, it is irrelevant to the Commission’s decision. The critical fact is that the non-mailing services that MOL customers will receive are now being performed by private printers and mail preparation firms who compete for customers with other private businesses, not with the Postal Service. Under MOL, these businesses will compete with the Postal Service for the same customers.

The Postal Service’s second claim is that it is not entering into the printing or telecommunications business, but instead is relying on private printers to perform the printing, finishing and mail entry functions associated with MOL. USPS Br. at 23. This claim is cold

comfort and obfuscates the real issue. There will be at most 25 private printers who contract with the Postal Service during the experiment. Those thousands of printers and mail preparation firms that do not get one of the 25 contracts do not have the Postal Service seeking customers for them. In effect, the Postal Service is extending its postal monopoly to non-mailing services by contracting out or deputizing the 25 contractors to perform these services rather than performing them directly. But the effect on private business is the same – the monopolist Postal Service is using its monopoly over mail delivery to channel non-mailing business to an infinitesimal portion of the private business world that has been fortunate enough to get one of the 25 contracts.<sup>1</sup>

In short, MASA and PII have clearly established the predicate necessary to require the Commission to consider competitive injury to mail preparation and printing businesses in reaching a recommended decision on the Postal Service request. See Initial Brief of Mail Advertising Service Association International and PrintImage International (“MASA/PII Br.”) at 3-7. These considerations call into question whether the Postal Service should be permitted to offer MOL at all. But, as discussed fully in the initial briefing, the competitive concerns raised by the MOL experimental request at a minimum counsel heightened vigilance by the Commission to be sure that all costs are accounted for and that MOL is priced at a level that minimizes the competitive threat to the many small printing and mail preparation businesses that must compete with the Postal Service to keep their customers. MASA/PII Br. at 3-26.

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<sup>1</sup> The Postal Service also contends that MOL “*may* increase the overall market” for lettershops. USPS Br. at 22 (emphasis added). It cites as support for this proposition the testimony from MOL I of witness Garvey, which is not a part of the record in this proceeding. Garvey’s testimony, even if considered, is the rankest speculation and not supported by any evidence. In short, there is no record support for the contention that MOL will increase business for lettershops.

## **II. THE COMMISSION SHOULD REJECT THE POSTAL SERVICE'S COSTING ARGUMENT**

The Postal Service contends in its initial brief that pre-experiment costs and product specific costs should not be attributed to the MOL experiment for purposes of determining the cost base to which the mark-up is applied. USPS Br. at 12-15. MASA and PII argued in their initial brief that Commission precedent requires that these costs be counted in the cost base before mark-up, and the Commission is referred to the relevant portions of the brief for these arguments. MASA/PII at 27-38. This reply will address the arguments made in the Postal Service's initial brief.

First, it should be recognized that the Postal Service does not contest either that the basic principle of cost attribution is causality or that each category of pre-experiment costs and product specific costs is caused by MOL. Instead, the Postal Service sets up a straw man, arguing based on witness Takis that the Commission has rejected fully distributed costing methodologies and that the mark-up will ensure that all costs caused by MOL are recovered. USPS Br. at 9-10, 12. The truth is that no one is advocating in this proceeding that costs at issue that were not "caused" by MOL should be "allocated" to MOL under an FDC methodology. The costs at issue were indisputably caused by MOL under all the accepted Commission decisions concerning identification of attributable costs. The Commission has been quite clear that such costs must be attributed to MOL (see MASA/PII Br. at 29-30), and the Postal Service has not cited any contrary authority, other than the irrelevant FDC decision in PRC OP R74-1, Vol. 1 at 124; USPS Br. at 10.

It is likewise, no answer to claim that the disputed costs will be recovered through the mark-up. Under long-standing Commission precedent, in pricing a postal product, the

Commission assigns all attributable costs and then determines the proper mark-up over those costs to ensure that the product makes an appropriate contribution to the institutional costs of the Postal Service. To be sure, the Commission also considers in setting the mark-up whether the service or product is likely to cover all its attributable costs, because that is one of the statutory criteria under the Postal Reorganization Act. But it turns the Act on its head and ignores Commission precedent to argue, as the Postal Service does, that attributable costs need only be recovered from the mark-up.

The Commission should be particularly wary of blazing new trails in this case with respect to the treatment of product specific and “pre-experiment” costs. MOL represents an entry by the Postal Service into non-mailing services, and presents a substantial risk of competitive injury to private business. All risk of underpricing the product – which would exacerbate the risk of competitive injury – should be avoided.

The Commission should also exercise caution because of the uncertainty of the Postal Service’s evidence. The Postal Service has refused to provide full information about certain shared costs, like advertising, and payment and registration systems. It has very likely understated Help Desk costs by a substantial margin. MASA/PII Br. at 34-36. To estimate volumes, it has relied on a market survey that was based on very unrealistic assumptions and is substantially out of date. It has repeatedly, throughout the course of MOL I and MOL II, missed deadlines and made predictions about the service that have proven unrealistic or unachievable. And it has apparently made marketing decisions – like the decision to spend only \$750,000 per year to make consumers aware of MOL – that appear misguided at best and almost guarantee that the Postal Service will fail to achieve its objectives.



The Postal Service has also erred in certain specific contentions. Its claim that pre-experiment costs should not be attributed to the experiment because it is an “entirely new system,” is belied by the obvious truth, acknowledged by the Postal Service elsewhere, that the MOL experiment is simply part of the progression of the product that was planned all along.<sup>2</sup> The argument that a “profit” in the market test would not be deducted from experimental costs (USPS Br. at 13) is likewise a red herring.<sup>3</sup> The Commission attributes costs, not “profits.” The effect of the product covering its attributable costs would have been a contribution to institutional costs greater or less than what was projected. But what in fact occurred here was that the Market Test was part of the start up of the MOL service and did not come close to covering its actual costs. The Postal Service should not be able to avoid the attribution of these costs simply by the happenstance that it withdrew its original experimental filing, and refiled a new case, which is now MOL II.

The Postal Service’s specific arguments for excluding product specific costs from the attributable cost base should also be rejected by the Commission. The Postal Service claims, without support, that the product specific costs for MOL are “different from that of the typical product specific costs since they generally will not be incurred on an ongoing basis and will not recur.” USPS Br. at 14. There is good reason to believe this is not true. As argued in the opening brief, the rate of change in technology intensive industries is so rapid that hardware and software is replaced and revised on a very regular and frequent basis. Without a more focused

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<sup>2</sup> The Postal Service brief characterizes the experimental proposal as “intended to provide for the *ramp up* of the service from its earlier market test phase.” USPS Br. at 3 (emphasis added). See also MASA/PII Br. at 32.

<sup>3</sup> The initial brief erroneously stated that MOL generated \$7 million in revenues during the Market Test. MASA/PII Br. at 16. In fact, Market Test revenues did not reach six figures.

and persuasive study of what specific costs might not recur, this argument simply has no evidentiary support in the record.

It is, moreover, without legal significance. Costs that are caused by a product are part of the attributable cost base to which the mark-up is applied. And, contrary to the argument that higher fees would “inhibit demand” (USPS Br. at 14), the danger that artificially lower fees will harm competition is much greater. In short, the Postal Service’s claim that exclusion of product specific costs from the cost base is an economically sound position (USPS Br. at 15), is supported by citation to no legal authority<sup>4</sup> and without factual foundation in the record.

### **III. THE DATA COLLECTION PLAN SHOULD BE MODIFIED TO ENHANCE ITS USEFULNESS**

The Postal Service data collection plan should be modified in three respects to make it more useful to the parties and the Commission.

First, the Postal Service should be required to report all advertising expenses incurred during the experiment in connection with the marketing of MOL specifically or of USPS.com or any other product that seeks to make the public aware of the Postal Service’s offer of online mail entry or other online products or services. The Postal Service’s refusal in this proceeding to provide estimates or information about these types of costs made it a fait accompli that the Commission and the parties could not effectively identify these costs and argue for their inclusion in the MOL experimental cost base. The Postal Service should be required to provide the information during the experimental data collection effort. The parties then can argue about the significance of the information for costing or other purposes when the time comes in the proceedings, if any, relating to a permanent classification.

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<sup>4</sup> The Postal Service’s sole citation is to its own briefs in prior cases arguing for positions that have not been adopted by the Commission. This is a strange citation of authority to say the least.

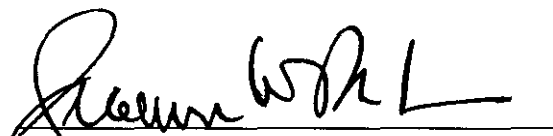
The Postal Service should also be required to collect information about customers concerning the source of MOL business so that competitive impact of MOL can be evaluated. While the Commission did not require such information to be collected during the Market Test, the Postal Service has since agreed to collect information about the source of volume generated during the Ride-Along Experiment and the Commission has approved the collection of this data. PRC Op., MC2000-1. There is no reason why similar data could not be collected here, and the competitive concerns presented by MOL are at least as significant if not more so.

Finally, the Postal Service proposes to file data reports on a semi-annual basis that are more condensed than those filed in the Market Test. USPS Br. at 25. While this frequency during the early part of the experiment should suffice, as the filing for a permanent service approaches, the Postal Service should be required to revert to monthly reporting. This is particularly so because the data that will have been reported by the time of a permanent filing is likely to be largely from the relatively immature stage of the product roll-out. As the parties and the Commission consider a request for permanent service, it will be important – indeed critical – to have up-to-date information concerning the mature MOL product to provide a reality check for the Postal Service’s predictions and estimates. Accordingly, MASA/PII requests that the Postal Service be required to deliver monthly data reports once a request for a permanent MOL service has been filed.

## CONCLUSION

For the reasons set forth above and in their initial brief, MASA and PII request that the Commission issue a recommended decision that prices any MOL experimental offering based on a cost base that fully recognizes the costs caused by MOL, marked up in the 50% range to ensure that the Postal Service does not engage in unfair competition with small businesses in the printing and mail preparation markets.

Respectfully submitted,



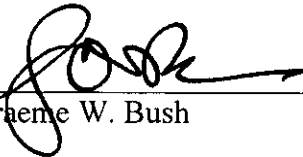
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Dated: March 27, 2000

CERTIFICATE OF SERVICE

The undersigned hereby certifies that the foregoing Reply Brief was served in accordance with Rule 12 of the Rules of Practice and POR No. MC98-1/4 this 27th day of March 2000.

  
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