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

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POSTAL RATE COMMISSION
OFFICE OF THE SECRETARY

Before

Chairman Edward J. Gleiman,
Vice Chairman George A. Omas,
Commissioners Dana B. Covington, Ruth Y. Goldway
and W. H. "Trey" LeBlanc III

Mailing Online Experiment

Docket No. MC2000-2

OPINION
AND
RECOMMENDED DECISION



Washington, DC 20268-0001
June 21, 2000

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RECOMMENDED DECISION

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SUMMARY

The Commission recommends the three-year Mailing Online experiment requested by the Postal Service, albeit with fees slightly above those proposed by the Service. The Commission's recommendation reflects both the record evidence on projected costs, and the application of statutory policies that require it to balance the interests of mailers, private businesses, and the Postal Service. During the experiment, the postage and fees for a typical two page First-Class piece sent via Mailing Online will be 40.9 cents under the Commission's recommendation, as opposed to the 37.9 cents suggested in the Postal Service's proposal.

Mailing Online allows individuals and businesses to transmit documents to the Postal Service via the Internet for printing, finishing, and posting as hard copy mail. The Service plans to combine items to be delivered in different parts of the country, and electronically distribute jobs to regional private printing contractors. Documents will then be printed, prepared for mailing, and entered into the local mailstream by the contractors.

The Commission approved a geographically limited market test of an earlier version of Mailing Online in Docket MC98-1. The Postal Service included in its Request in that docket an associated proposal for a two-year, Mailing Online experiment to immediately follow the market test. However, the Service encountered technical difficulties in its market test, and in May 1999, it withdrew its proposal to conduct an expanded Mailing Online experiment. Six months later, it submitted this new Request for a longer, nationwide experiment incorporating revised information technology and adjusted cost projections. If this experiment is successful, the Postal Service intends to seek authority to establish Mailing Online as a permanent service.

Participants in this case have focused their attention largely on whether the Postal Service's status as a statutory nationwide monopoly gives it an unfair advantage

as it enters the mixed electronic/hard copy communications market, and on whether the Service accurately identifies Mailing Online costs. During the course of this proceeding, a settlement agreement was agreed to by several participants under which the Postal Service will allow functionally equivalent, competing electronic/hard copy services to mail their products at the same postage rates the Service intends to charge Mailing Online. This alleviated much of the concern about unfair competition.

The Commission finds that Mailing Online, as recommended, does not constitute unfair competition by the Postal Service. The Postal Service can and should develop innovative services. The Commission's recommendations should neither act as a bar to Postal Service entry into the hybrid mail arena, nor result in an unfair competitive advantage for the Service.

The Commission has identified certain attributable information technology costs, product specific advertising, and revenue collection expenses not recognized in the Service's Request. The cost basis of the service has been increased accordingly.

Some participants suggest that fees during the experiment should be increased further to recover more of the costs of development of Mailing Online. For example, printer contracts guarantee a minimum annual volume, and because volume during the market test was significantly below projections, the Postal Service paid a substantial penalty. However the Commission has determined that it is not appropriate to burden users during the experiment with all of the development expenses incurred during the market test. If the service becomes permanent, such development costs will be recouped over time by Mailing Online fees.

The recommended fees for Mailing Online include a higher markup over attributable costs than proposed by the Postal Service. The Commission balances the desirability of the low markup requested by the Postal Service to promote this experimental service, with the fact that Mailing Online unit costs are based on speculative volume estimates, and that some protection should be provided so that

monopoly rate payers and small businesses providing competing services are not unreasonably harmed should volumes fail to materialize. The Commission therefore recommends fees reflecting the statutory pricing factors that will provide a markup equal to the average for all other postal subclasses and services.

I. INTRODUCTION

A. Description of Mailing Online

Mailing Online gives Postal Service customers who have access to a personal computer and the Internet the ability to transmit documents created on their personal computers to the Postal Service for subsequent printing, finishing, and entry as hard copy mail. Customers create a document to be mailed, along with a recipient mailing list, including optional individualized information to be merged with each recipient's mailing, on their personal computer. The customer then initiates contact with the Mailing Online service through the Postal Service Internet website (www.USPS.com).¹ The document and recipient mailing list files are transmitted to the Postal Service through the web site, various printing and finishing options are selected, and payment for the applicable postage and pre-mailing services is made while online.²

The Postal Service processes the data files containing the document, address list, printing options, and customer information. Address hygiene, and merging of names, addresses, and recipient-specific information with the document files are performed in the process of creating print-image files that will be sent to commercial printing contractors.³ Information is compiled to allow files from different customers with like printing and finishing characteristics to be batched and presorted where possible.⁴ The print-image files, along with batching and presorting information, are sent to one or more print sites based on the destination ZIP Code of the individual mail piece. The

¹ USPS-T-1 at 1.

² Request at 2.

³ USPS-T-1 at 2.

⁴ *Id.* at 5-6.

Postal Service anticipates having 25 geographically diverse print sites available during the second year of the experiment.⁵

The commercial printing contractor will print and finish the documents, place them in addressed envelopes, and enter the mail pieces at a local postal facility for delivery. The customer will receive electronic confirmation when the documents are received at the print site, when the printing is complete, and when the mailing is deposited at the postal mail-processing facility.⁶

The Postal Service expects the largest potential source of Mailing Online volume will be short-run, direct mail advertising and solicitation.⁷ The market test confirmed that the users of Mailing Online might include individuals, small businesses, home offices, and charitable organizations. However, Mailing Online may not be suitable for larger mailers who currently have more economical ways of entering mail.⁸

The Postal Service proposes that Mailing Online customers be charged postage plus a fee for production and other pre-mailing services. Postage would be charged at either:

- Express Mail Next Day Service and Second Day Service,
- First-Class Mail Letters and Sealed Parcels Automation Letters Basic,
- First-Class Mail Letters and Sealed Parcels Automation Flats Basic,
- First-Class Mail Cards Automation Basic,
- First-Class Mail Single-Piece Priority Mail,
- Standard Mail Regular Automation Basic Letters, or

⁵ USPS-T-1 at 2.

⁶ *Id.* at 6.

⁷ USPS-T-1 at 8.

⁸ Larger mailings may be able to utilize deeper discounts than the automation basic presort rate offered with Mailing Online. Request at 4. Additionally, the economics of on-demand digital printing offered with Mailing Online may not be acceptable for longer print runs. USPS-T-1 at 8.

- Standard Mail Regular Automation Basic Flats.⁹

Eligibility for Standard Mail Nonprofit Automation Basic and Standard Mail Nonprofit Automation Basic Flats rates also may be introduced during the experiment. Mail pieces that have addressing that does not meet Postal Service requirements will be charged single-piece rates for either First-Class Mail Letters and Sealed Parcels or First-Class Mail Cards.¹⁰ Special services will also become available during the experiment with customers paying the existing special service rates.¹¹

The proposed fees for production of the mail pieces and other pre-mailing services are based upon the actual unit contract printer cost for the services purchased and the volume variable portion of information technology costs.¹² The unit contract cost may vary across the 25 proposed print sites.¹³ The proposed fees charged the customer are calculated by multiplying 1.30 times the sum of the unit contract printer cost for the services purchased and 0.1 cents per impression for information technology costs.¹⁴ This results in a 130 percent cost coverage based on the printer contract costs plus the volume variable information technology costs.

B. History of Mailing Online

The Postal Service conducted a basic operations test of a prototype Mailing Online service from March 1998 through September 1998. The test was limited to two hundred participants located in Tampa, Florida and Hartford, Connecticut. The Mailing Online system consisted of one print contractor, located in Texas, and one postal web

⁹ Request, Attachment A at 4.

¹⁰ *Id.* at 4-5.

¹¹ USPS-T-5 at 11.

¹² *Id.* at 4-6.

¹³ USPS-T-2 at 2.

¹⁴ Request, Attachment B at 2.

server. Customers paid the single piece First-Class Mail postage rate, but were not charged for pre-mail processing, i.e., processing of the documents and mailing lists prior to the induction of the printed matter as mail. The test was designed to provide the information and experience necessary to formulate a viable experiment for Mailing Online.¹⁵

On July 15, 1998, the Postal Service filed a request with the Commission for an opinion and recommended decision on both a Mailing Online market test and a more extensive Mailing Online experiment.¹⁶ The Mailing Online experiment was scheduled to follow the Mailing Online market test. PRC Order No. 1217, issued on August 21, 1998, bifurcated the docket into a market test phase and an experiment phase, with separate future consideration being given to the experiment phase. The Recommended Decision on Market Test, Docket No. MC98-1, only considered and recommended the market test phase of Mailing Online.¹⁷

The Mailing Online market test was conducted from October 30, 1998, through October 29, 1999, following the completion of the basic operations test. The market test expanded upon the operations test and added New York City, Boston, and Philadelphia as test cities. Customers paid the Automation Basic Presort postage rate in addition to pre-mail processing charges based upon actual contract printer costs for the service. The Postal Service conducted further tests of the prototype technology, validated customer acceptance of the Mailing Online concept, and gained knowledge about contract print/mail vendor relationships.¹⁸

¹⁵ USPS-T-1 at 9.

¹⁶ Docket No. MC98-1, Request of the United States Postal Service for a Recommended Decision on a Market Test Classification and Fee Schedule, and a Recommended Decision on an Experimental Classification and Fee Schedule for Mailing Online Service.

¹⁷ PRC Opinion, Docket No. MC98-1.

¹⁸ USPS-T-1 at 9-10.

The market test experienced a serious lack of capacity and stability in the test software, a limit on the number and location of users, and an incomplete technical implementation at the contract printer location. Marketing efforts were deliberately slowed to limit additional traffic to the market test web site. The resulting market test volume was lower than expected. Although market test volume levels fell short of expectations, the Postal Service still gained experience with merger of customer jobs, printer contracting, and mail entry issues.¹⁹

On May 5, 1999, the Postal Service filed a notice of withdrawal of the request for an opinion and recommended decision on the experimental phase of Docket No. MC98-1.²⁰ The notice followed the Postal Service decision to consolidate its Internet presence within one web site, USPS.com. This strategic change rendered inaccurate the cost foundation underlying the request for a Mailing Online experiment.²¹ The Postal Service indicated it hoped to file a new request for an experiment in the future that would incorporate changes in its operating plans for Mailing Online. PRC Order No. 1241, issued May 12, 1999, terminated Docket No. MC98-1, thus ending consideration of the Mailing Online experiment associated with Docket No. MC98-1.

The instant Request, docketed as MC2000-2, is the new request for a Mailing Online Experiment. It incorporates both system architecture and financial data revisions to the withdrawn experiment in Docket No. MC98-1.

¹⁹ *Id.* at 10-11.

²⁰ Notice of United States Postal Service of Withdrawal of Request for a Recommended Decision and Motion to Close Docket, MC98-1.

²¹ Request at 2.

II. PROCEDURAL HISTORY

A. Request for Expedited Decision

The Postal Service request is accompanied by a Motion of the United States Postal Service for Expedition, and for Waiver of Certain Provisions of Rule 161 and Certain Provisions of Rule 64(h) (Motion for Expedition). In this pleading, the Service asks the Commission to expedite consideration of its request as provided for in the experimental service rules and to issue a decision that would allow the Postal Service's preferred objective of implementing the Mailing Online experiment as soon as mid-April 2000. Pursuant to rule 64(h)(3), the Postal Service also asks to be relieved of the obligation to produce certain information regarding cost and revenue effects of its proposal, on the grounds that its proposal would not change any existing rates or fees, or produce a significant impact upon the cost-revenue relationships of existing postal services.²² Specifically, the Service seeks waiver of rules 54(b)(3) in part, 54(f)(2), 54(f)(3), 54(h), 54(j), and 54(l) in part.²³

There was no objection by the participants to the Postal Service Motion for Expedition. The Request is for a service that is currently not available and that should have limited impact on Postal Service cost and revenues. Therefore, the Commission granted the Motion for Expedition by waiving the specified rule 64(h) informational filing requirements and scheduling this docket to proceed pursuant to rules 67a through 67d for requests involving experimental changes.²⁴

During the February 24, 2000 hearing, the Postal Service indicated the schedule for launching Mailing Online as planned could slip "a couple of months" although a

²² Motion for Expedition at 3-5.

²³ *Id.* at 5-6.

²⁴ Tr. 1/9-10.

limited "bridge" system could be in place sooner.²⁵ The Service expressed the possibility, with low confidence, that the system might be available by mid May. Because of this, the Commission did not accelerate the filing of briefs and reply briefs as planned when it determined that participants were not going to file rebuttal cases in this docket and subsequently granted the Postal Service's Joint Motion for Extension of Time in Which to File Reply Briefs.²⁶ This Opinion has been expedited to the extent necessary to allow the Postal Service to launch Mailing Online as soon as feasible.

The Postal Service's direct case was presented through the introduction of five new pieces of testimony.²⁷ Witness Garvey, USPS-T-1, describes the policies, business objectives, and planned operation of the Mailing Online experiment.²⁸ Witness Poellnitz, USPS-T-2, estimates the print contractor costs and advertising costs. He also summarizes the information technology (IT) costs presented by witness Lim, USPS-T-3. Witness Lim also separates costs into dedicated hardware, software, telecommunications/networking, and related personnel and service costs. Witness Takis, USPS-T-4, explains the principles of cost causality used to allocate costs from a shared infrastructure system to specific supported products such as Mailing Online. Finally, witness Plunkett, USPS-T-5, presents the pricing and classification analyses for Mailing Online. No other participant presented a direct case in this docket.²⁹

²⁵ Tr. 4/1339-40.

²⁶ Additional time was added to the schedule to file reply briefs. See POR No. MC2000-2/9, Presiding Officer's Ruling on Extension of Time to File Reply Briefs, March 21, 2000.

²⁷ Parties, including the Postal Service, also re-introduced prior testimony by designating material that was entered into the MC98-1 record. Significant to the Postal Service case was the designation of witness Rothschild's testimony from Docket No. MC98-1. Witness Rothschild provides the volume estimates that other Postal Service testimony is based upon. Section B of this Opinion and Recommended Decision further discusses the designation of testimony.

²⁸ Witness Garvey was replaced by witness Plunkett during the pendency of the hearing. Notice of United States Postal Service Regarding Substitution of Witness, January 3, 2000. Witness Plunkett adopted the testimony and cross-examination of witness Garvey. Tr. 2/69-71.

²⁹ The Office of Consumer Advocate initially filed the testimony of witness Callow, OCA-T-100. This testimony was withdrawn prior to entry into the record. Office of the Consumer Advocate Notice of

Mail Advertising Service Association International and PrintImage International (MASA/PII), the Office of the Consumer Advocate (OCA), and the United States Postal Service filed briefs in this docket.³⁰ The MASA/PII Brief discusses the anti-competitive effect of Mailing Online, the calculation of attributable costs, and setting a cost coverage that recognizes the potential for competitive harm. The OCA Brief discusses the product-specific costs and the Postal Service's volume estimates as related to the information technology fee, and the proposed data collection plan. The USPS Brief supports its position for offering the Mailing Online service. The same participants also filed reply briefs in support of their initial briefs and in rebuttal of opposing arguments.³¹

B. Volume Estimates

The Postal Service accompanied the Request with a motion to designate as record evidence in this docket the direct testimony and cross-examination of Postal Service witness Rothschild from Docket No. MC98-1.³² No participant opposed the motion to designate the Rothschild material, although the OCA did file an answer.³³

Withdrawal of the Testimony of Witness James F. Callow (OCT-T-100), February 23, 2000.

³⁰ Mail Advertising Service Association International and PrintImage International submitted a combined brief. The initial brief submitted contained typographical omissions. Therefore, a replacement brief was submitted. All references are to the replacement brief. The briefs will be referred to as: MASA/PII Brief, OCA Brief, and USPS Brief.

³¹ The reply briefs will be referred to as: MASA/PII Reply Brief, OCA Reply Brief, and USPS Reply Brief.

³² Motion for Designation of Testimony and Cross Examination From Previous Docket as Evidence in Commission Docket No. MC2000-2, filed November 16, 1999. The referenced direct testimony is the Direct Testimony of Beth B. Rothschild on Behalf of United States Postal Service, PRC Docket No. MC98-1, USPS-T-4. The referenced cross-examination testimony is in the Official Transcript of Proceeding, PRC Docket No. MC98-1, Vol. 2, at 428-79. The cross-examination testimony was transcribed into the MC2000-2 record at Tr. 3/293-345. Additional cross-examination, not covered by the motion, was also designated and transcribed into the MC2000-2 record at Tr. 3/346-354. The direct testimony was entered, but not transcribed. Tr. 3/292 and Tr. 4/1335.

³³ Office of the Consumer Advocate Response to Motion of the Postal Service to Designate the Testimony and Cross-examination of Witness Rothschild From Previous Docket as Evidence in Docket No. MC2000-2.

The purpose of witness Rothschild's testimony is to sponsor a study titled NetPost Research—Survey Methodology & Results prepared for the Postal Service by National Analysts, Inc. dated July 10, 1998.³⁴ The research evaluated the market response to a proposed product named NetPost. NetPost was a tentative name assigned to a product that, for the purpose of this testimony, is now called Mailing Online. The goal of the research was to provide volume estimates that could be realized under different product configurations. Projections were made under two different rate schedules—one using a 25 percent markup and one using a 50 percent markup. Also, two difference system configurations were studied. The first configuration was a basic Mailing Online system. The second configuration contained expanded features and services.

The Postal Service motion was granted on December 21, 1999.³⁵ In granting the motion, several concerns with the reliability of the testimony were considered. First, some of the data originated with focus groups conducted in December of 1995. The concern was the age of the testimony in comparison to the rapid development of the Internet. Second, the study was for a system that was not exactly the same in features or price markups as the proposed Mailing Online system. Finally, the study was conducted to determine if there was enough volume to implement a system, not to support a Commission filing. Nonetheless, the benefits of conducting a new study did not outweigh the cost, time, and probability of obtaining a more reliable estimate of volume. Furthermore, the purpose of this experiment is not to confirm the Rothschild volume estimates. The purpose is to generate experience and data to support a filing for a permanent version of Mailing Online. The experiment itself should give a better indication of volume to support a permanent filing for Mailing Online than a new market study.

³⁴ See Library Reference USPS-LR-2/MC98-1

³⁵ P.O. Ruling No. MC2000-2/4.

On brief, the OCA argues that the volume estimates may be overly optimistic and should be viewed with skepticism.³⁶ The OCA alleges that three assumptions made by witness Rothschild tend to overstate the probable usage of Mailing Online.

First, respondents were given the impression that almost any type of file created on their computers would be a candidate for MOL service, when this is not the case. Second, respondents were led to believe that the speed of service they would receive via MOL (then called NetPost) far exceeds the speed of service that the Postal Service now anticipates for MOL. Third, witness Rothschild assumed a level of awareness that is not likely to be achieved given the extremely limited advertising budget currently planned.³⁷

The volume estimates directly impact the calculation of the proposed unit IT fee, with lower volumes resulting in a higher unit IT fee. The OCA questions the volume estimates in order to propose setting the unit IT fee conservatively high.

The Postal Service addresses the OCA concerns in its reply brief. The Service points to the lack of alternative computer programs available today to the programs that are being offered as compatible with Mailing Online.³⁸ Even if an incompatible program or incompatible "sophisticated graphical insert" is used, the file may still be transmitted using the Portable Document Format (PDF). The Postal Service did not directly address the OCA concern that two of the five high priority uses for Mailing Online, invoices and forms, typically would not be produced by software compatible with Mailing Online.³⁹ On the second OCA point, the Postal Service states it is only speculation that

³⁶ OCA Brief at 14-15.

³⁷ *Id.* at 15-16.

³⁸ USPS Reply Brief at 24-25.

³⁹ The five high priority applications are: (1) invoices/statements, (2) announcements/confirmations, (3) advertising mail, (4) newsletters, and (5) forms. Docket No. MC98-1, USPS-T-4 at 4.

the speed of service and cut-off times proposed in the Rothschild survey influenced the respondents to the study.⁴⁰

Finally, the Postal Service addresses the OCA contention that witness Rothschild assumed a level of awareness not likely to be achieved given the extremely limited advertising budget currently planned.⁴¹ The Postal Service claims that the volume study was based on conservative levels of awareness and states that the OCA raises this issue because OCA is of the opinion that the Postal Service has not budgeted enough for advertising. The Service questions the correlation between the amount of advertising expenditure and the amount of volume generated. The Service discusses the amount spent on advertising versus its effectiveness in terms of the lessons learned from the market test. The record shows the Service is considering a more directed marketing strategy than it used in the market test.⁴²

The Commission recognizes the limitations of the Rothschild survey. However, it provides a usable, if somewhat speculative, estimate of Mailing Online volume. The three matters raised by OCA identify reasons why the estimates are "soft," but they do not justify total rejection of the estimates. The impact of the first two factors should be limited because today's users are more familiar with the electronic transmission of data, and the inherent associated problems, partly because of the explosion in Internet usage. The OCA, on brief, appears to generally agree by stating: "Users of today are more sophisticated than those polled at the time of the NetPost research."⁴³ Advertising will be addressed in the data collection plan and is one of the areas of interest if the Postal Service files for a permanent Mailing Online service. The record does not offer any basis to recommend increasing the advertising budget.

⁴⁰ USPS Reply Brief at 25-26.

⁴¹ *Id.* at 26-29.

⁴² Tr. 2/243-45.

⁴³ OCA Brief at 17.

The experiment is the appropriate place to prove or dispel the OCA concerns, and corrective action, if necessary, can be taken by the Postal Service prior to a request for a permanent service. The rates recommended for Mailing Online reflect a markup equal to a systemwide average. An average markup provides some assurance that Mailing Online will recover its costs even if it fails to achieve the volume levels predicted by Witness Rothschild. In reviewing the OCA concerns two related issues were uncovered that need to be addressed. The Commission is concerned that the Postal Service does not have an advertising plan for Mailing Online, and does not share the Postal Service view that it is inappropriate to have a plan in place prior to the service being ready for launch.⁴⁴ Given the limited life of the experiment, the Commission considers it prudent that a marketing and advertising plan be in place as soon as possible. The OCA's speed of service concern highlights a second issue. The Commission recommends that the Mailing Online website indicate clear cut-off times and speed of delivery for the different services offered.

The Commission accepts the Rothschild volume estimates for what they are—estimates. One can speculate as to the accuracy of the estimates, but there is no record evidence providing contradicting data. In any event, one of the purposes of the current Mailing Online proposal is to gather data. The benefit of using the Rothschild estimates and proceeding with the experiment, where real data can be gathered, outweighs the potential risk that the volume estimates have been overstated. The Commission nevertheless considers the reliability of volume estimates, along with many other factors, in recommending rates for Mailing Online.

C. Designation of Other Material

A procedure was instituted to allow designation of relevant testimony, other than

⁴⁴ Tr. 2/143.

the Rothschild testimony, from Docket No. MC98-1.⁴⁵ Designating testimony is viewed as a timesaving procedure to avoid repeating testimony and cross-examination that is relevant and that has previously been presented to the Commission. All participants were allowed to designate relevant testimony from Docket No. MC98-1. Procedures were implemented to allow objections to designations, counter-designations, and updates to designated testimony. Updated testimony was subject to discovery and/or cross-examination. MASA, OCA, Pitney Bowes, and the Postal Service availed themselves of this procedure to enter approximately 800 pages of testimony into this docket.

The propriety of designating one witness's testimony was questioned using this procedure. MASA designated witness Stirewalt's previous testimony referenced as Docket No. MC98-1, Tr. 3/713-17, Tr. 3/757-63, and Tr. 5/965-70. The Postal Service objected to designating this testimony and, in the alternative, the Postal Service submitted counter-designations. The Postal Service claims that witness Lim's new testimony supersedes witness Stirewalt's old testimony and the inclusion of witness Stirewalt's testimony will only confuse the record. MASA argues that witness Stirewalt's methodology is relevant and sheds light on flaws in witness Lim's methodology in estimating Help Desk costs. The Presiding Officer concluded that the Commission is sufficiently expert to give appropriate weight to this evidence and admitted into evidence both the MASA designations and the Postal Service counter-designations.⁴⁶

⁴⁵ Presiding Officer's Ruling on Designation of Testimony and Cross-Examination From Docket No. MC98-1 (December 21, 1999), P.O. Ruling No. MC2000-2/4.

⁴⁶ Tr. 4/1306. The witness Stirewalt testimony and counter-designations appear at Tr. 4/1308-34.

III. THE POSTAGE TO BE PAID BY MAILING ONLINE PIECES

A. Automation Basic Presort Rates

The Postal Service proposes automation basic rates be made available to Mailing Online customers irrespective of the number of pieces in a given transaction.⁴⁷ Customers electing Priority Mail or Express Mail would pay the single piece rates. Witness Plunkett argues automation basic rates are selected as a proxy to be used during the experiment while information is collected on what the appropriate rate or set of rates for Mailing Online should be, not because automation basic are the rates that Mailing Online pieces would attain on average.⁴⁸ The mail entering the mailstream will be clean mail sorted to the greatest depth of sort possible.⁴⁹ Furthermore, Mailing Online pieces will meet all addressing and machinability requirements for automation rates and, at projected volumes, will achieve depth of sort that is on average greater than required.

Automation basic is the first level (least discounted) of the automation-compatible work-sharing discount rates. Automation basic mail must be presorted, marked, and presented as specified. It must bear a barcode and meet machinability, addressing, and other preparation requirements. To qualify for automation rates, First-Class letters, flats, and cards must be prepared in minimum quantities of at least 500 pieces. Standard A letters or flats must either be prepared in minimum quantities of at least 200 pieces or contain at least 50 pounds of addressed mail.

For the experiment, the Postal Service proposes to offer automation basic rates, but waive the minimum quantity requirement. This solves a practical pricing problem

⁴⁷ USPS-T-5 at 11. Automation basis rates apply to First-Class Mail Letters and Sealed Parcels, Standard Mail Regular, Standard Mail Nonprofit, and First-Class Mail Cards.

⁴⁸ Tr. 2/149.

⁴⁹ Mailing Online mailings are always presorted in walk sequence order. USPS Brief at 18.

particular to the Mailing Online system. An individual mailer may not have the requisite quantity of mail to qualify for automation discount rates. However Mailing Online batches mailings each day from many different mailers. When the mailings are batched and presented to the Postal Service, current volume projections indicate the batched mail should qualify for a rate lower than the single piece rate.

The practical problem occurs because the Postal Service does not know what level of presortation discount the batched mail will qualify for at the time the individual mailer enters a Mailing Online order. The exact discount this mail will qualify for cannot be determined and is the subject of this experiment. The automation discount rates account for the work-sharing and automation compatible features built into the Mailing Online system and represent the Postal Service cost savings in processing this mail. The Postal Service proposes to pass through the cost savings to the mailer by making a lower rate available. There is also a possibility that on some days a batch may not include sufficient volume to qualify for any automation rate. An individual order could not be complete until the final postage price is determined. Possible solutions were proposed during the market test, but not agreed to, such as a rebate system, and a system for calculating the average postage cost over a period of time. The solution that was accepted for the market test and that is proposed for the experiment is to charge everyone the automation basic rate at the time the order is placed.

The use of automation basic rates and the exemption from the minimum volume requirements were controversial in market test decision. The Postal Service was allowing itself the exemption from the minimum volume requirement for automation basic rates, but was not offering to extend the exemption to other systems that were functionally equivalent to Mailing Online. The arguments revolved around the alleged competitive advantage that the Postal Service was giving itself over other similarly situated users of the mail.⁵⁰ Because other users of the mail were not eligible for the

⁵⁰ PRC Opinion MC98-1 at 18-20.

same rates or exemptions, they could incur higher postage cost than the Postal Service, while offering the same service. The Postal Service replied that a similar service could qualify for even greater discounts than automation basic, depending upon volume, thus putting Mailing Online at a disadvantage.

The Postal Service did not directly oppose making automation basic rates with the minimum volume exception available to functionally equivalent systems during the market test. The problem became defining a workable definition of a "functionally equivalent" system to Mailing Online. In response to a Notice of Inquiry, the Service proposed a six-part test for functional equivalency.⁵¹ The definition contained several features that the competition did not consider relevant to preparing mail under a functionally equivalent system. An agreement was not reached on a workable definition of functional equivalency for the market test.

The Docket No. MC98-1 Opinion recommended a market test in which postage was set at automation basic rates with no minimum volume requirement. The exemption from the minimum volume requirement was not made available to functionally equivalent systems. The Opinion reasoned that the market test was of such limited scope and duration that any harm to potential competitors of Mailing Online caused by the disparity in rates was likely to be minor. This same reasoning does not carry forward to the experiment. The experiment is proposed to run for three years. This is considerably longer than the market test, and a relatively long time in the life cycle of rapidly evolving Internet generated products and services. The scope of the service has also expanded from a regional market test to a national experiment. The probable impact on competition will increase without provisions to make the same rates available to providers of similar services.

In this docket, MC2000-2, several of the participants, including the Postal Service, reached agreement on a definition of functional equivalency. They urge that a

⁵¹ The six-part market test functional equivalency requirements are designated at Tr. 4/646-48.

product functionally equivalent to the Postal Service's Mailing Online be able to qualify for the same postage rates as the Postal Service will charge Mailing Online. The functional equivalency definition should alleviate many of the concerns of businesses desiring to implement competitive products by allowing them to use the same postage rates as Mailing Online. The definition will be incorporated in the Domestic Mail Classification Schedule (DMCS) and is discussed in detail in the DMCS Stipulation and Agreement section of this Opinion.

Automation basic rates appear acceptable because they are reasonably likely to be revenue neutral over the duration of the experiment. Revenue loss created by accepting mailings that do not meet the automation basic minimum volume requirements may be offset by revenue gains from accepting high quantity mailings that would otherwise qualify for deeper discounts than automation basic. Automation basic rates incorporate a substantial markup that also will ameliorate potential loss if projected volumes are not met. The reasoning of the market test Opinion in conjunction with a workable definition of functional equivalency that allows competing services access to the same postage rates that are available to the Postal Service support accepting the Postal Service's postage rate proposal. The Commission recommends that automation basic rates, including the minimum volume exemptions, be made available for the Mailing Online experiment.

B. DMCS Stipulation and Agreement

On February 24, 2000, the Postal Service filed a Stipulation and Agreement that modified the DMCS language originally proposed in the Request. Carlson, the OCA, Pitney Bowes and the Postal Service signed the agreement. The agreement proposes DMCS language that allows systems that are "functionally equivalent" to Mailing Online to qualify for the exemption from minimum volumes as applied to automation basic

rates. The agreement does not propose changes in Fee Schedule 981.⁵²

The key to this agreement is the definition of a functionally equivalent system to Mailing Online. A definition was discussed when the Mailing Online market test was under consideration, but agreement could not be reached.⁵³ This agreement is a major step forward in resolving inequities that may have existed in postage rates between Mailing Online and the competition. The Commission recommends the proposed DMCS language in the Stipulation and Agreement. However, because of the general nature of the terms used in the agreement, the Commission provides interpretations and clarifications to be used when applying the definition.

A preliminary concern is during what time period a proposed equivalent system is tested as being functionally equivalent to Mailing Online. The Mailing Online system is an evolving system with new additional features being planned. What is functionally equivalent today, may not be functionally equivalent tomorrow.⁵⁴ Two aspects of functional equivalency must be distinguished to fully examine the time period issue.

The first relates to the level of service offered. The level of service can be defined as what options are offered to the customer. This includes items such as choice of colors, printing and finishing options, mailing options (Express Mail, First-Class Mail, etc.), choice of paper, paper sizes, page count limits, etc. The Stipulation and Agreement does not address what level of service is required to be functionally equivalent to Mailing Online. This would be extremely difficult to incorporate into the DMCS because the Postal Service will be changing its own level of service throughout

⁵² The Commission notes that Fee Schedule 981 must be modified because of the Stipulation and Agreement. The Stipulation and Agreement provides for an annual certification fee that normally would appear in Fee Schedule 981.

⁵³ See Tr. 4/646-648 and Tr. 657-701 for oral testimony concerning functionally equivalent systems that occurred in MC98-1. This testimony shows the contentious nature of trying to arrive at an agreeable definition of a functionally equivalent system.

⁵⁴ Tr. 4/729-30. "I would admit that functional equivalence is a moving target in this instance." Tr. 4/730.

the experiment. The Commission recommends that the Postal Service not consider the level of service offered when determining if a proposed service is functionally equivalent.

The second relates to the operation of the Mailing Online system. The operation of Mailing Online includes items such as batching, sorting, commingling, average minimum volumes, use of electronic documents, etc. This is addressed in the Stipulation and Agreement and appears as the definition of functional equivalency in proposed DMCS § 981.62. The definition contains a four-part test for functional equivalency. Before discussing the individual parts of the test, how the test will be applied must be examined in relation to the changes that will be made to the Postal Service system over time.

It would be inherently unfair to require a service provider to qualify a system with operational features in excess of what the Postal Service is capable of and actually providing at the time the service provider applies for functional equivalency. This includes requiring a service provider to modify its system whenever the Postal Service makes a change to its system. It would also be unfair to apply different standards to different service providers based on the time of the application for equivalency given the relatively limited duration of the experiment.

When applying the criteria listed in the DMCS, the Commission recommends that the Postal Service examine the proposed functionally equivalent system in relation to what Mailing Online is actually providing at the time of the application for equivalency. Whatever level of service that the initial functionally equivalent system qualifies at should set the minimum level of functional equivalency for the duration of the experiment. This initial level of service will set the benchmark for all other competitors that apply for functional equivalency. The benchmark should not change when applying for renewal of functional equivalency at the end of the one-year certification. A request for permanent authority may, of course, contain an altered test

of functional equivalency.

The four-part definition of functional equivalency is included in DMCS § 981.62. A functionally equivalent system must be capable of providing service in accordance with each part of the test when compared with Mailing Online. Each section will be reviewed in sequence.

Subpart "a" states a functionally equivalent system is capable of, when compared to Mailing Online:

- a. accepting documents and mailing lists from remote users in electronic form, such as via the Internet, or converting documents and mailing lists to electronic form;

This subpart was not discussed on the record or on brief by the parties and is recommended by the Commission.

Subpart "b" states a functionally equivalent system is capable of, when compared to Mailing Online:

- b. using the electronic documents, mailing lists, and other software including sortation software certified by the Postal Service that sorts to the finest level of sortation possible, to create barcoded mailpieces meeting the requirements for automation category mail, with 100 percent standardized addresses on all pieces claiming discounted rates;

This subpart imposes a requirement for 100 percent standardized addresses on all pieces claiming discounted rates. On brief, MASA/P11 alleges that this creates an inequity denying functional equivalency if all addresses are not standardized, whereas the Postal Service has the option of mailing non-standardized addressed items at the single piece rate. The Commission does not share this view. Competing services and the Postal Service both are able to cull non-standard addressed items and mail them at the single piece rate.

Subpart "c" states a functionally equivalent system is capable of, when compared to Mailing Online:

- c. commingling mailpieces from all sources without diversion to any other system and batching them according to geographic destination prior to printing and mailing; and

This subpart imposes a requirement for commingling mailpieces from all sources. The Commission interprets this as a general requirement for commingling. It should not be interpreted to require commingling to any greater extent than the Postal Service is commingling at the time an application for functional equivalency is made.

On brief, MASA/PII questions the subpart “c” language that requires commingling and batching prior to printing and mailing. MASA/PII alleges that this will have no conceivable effect on the Postal Service’s costs to handle and deliver the mail. Furthermore, this “meaningless” requirement will limit a competing service in developing a system that might have greater efficiencies through differences in design. The Commission can only conjecture on this issue because the record is void of discussion. The requirement may not affect the cost to handle and deliver mail, but it is not meaningless. The requirement forces alternate systems to resemble Mailing Online in some ways as a minimal requirement to being considered functionally equivalent to Mailing Online. This does not inhibit another service provider from developing a competing system that does not resemble Mailing Online, and having that competing system qualify for discount rates. It does inhibit another service provider with a dissimilar system from qualifying for the exemption from minimum volume. The Commission recommends the proposed language in subpart “c” only for the duration of the experiment.

Subpart “d” states a functionally equivalent system is capable of, when compared to Mailing Online:

- d. generating volumes that exceed on average any otherwise applicable volume minimums.

This subsection imposes a requirement for volumes that exceed on average the otherwise applicable minimum volumes. “On average” implies a time frame to average

over.

On brief, MASA/PII raised a concern that the Postal Service will always be eligible for the minimum requirement exemption whereas other service providers have to meet the averaging requirement from day one. This would be the case regardless of ramp-up, limited batching, or any other problems encountered. The Commission agrees with the MASA/PII analysis, but also views any potential inequities ameliorated by the “on average” test viewed over the duration of the experiment. The Rothschild volume estimates have been accepted, and although the Service may not qualify for automation basic without the exemption at the start of the experiment, by the end of the experiment the level of presort should be greater than automation basic.

For other service providers, defining the “on average” time frame could reduce a perceived inequity. The Commission expects, noting the lack of record evidence on this issue, that the averaging time frame be substantial—months as opposed to weeks.⁵⁵ This is especially important for a new service during the ramp-up phase when volumes are likely to be lower than or not as consistent as with a fully established service. The Commission suggests that the Postal Service make an educated prediction of the time period required before Mailing Online will on average exceed the minimum volume requirements. This same “grace period” should be granted to the competitors of Mailing Online under the functional equivalency definition.

The Commission expects that the Postal Service will liberally interpret and apply the definition of functional equivalency keeping several Mailing Online goals in mind. The first goal is to demonstrate the feasibility of this approach for overcoming concerns of anti-competitive action by the Postal Service. Only through fair and evenhanded administration of the process will the Postal Service overcome the expectation that it wants to charge Mailing Online customers lower postage rates than it is willing to offer

⁵⁵ There are many methods to perform averaging, including methods that apply more weight to recent events than to those occurring in the past. The Postal Service should examine these alternative averaging methods to develop an equitable systems for measuring “on average.”

competing mixed electronic/ hard copy services. Another major goal is to increase the overall Postal Service mail volume. The Postal Service will benefit if functionally equivalent systems expand markets utilizing Postal Service delivery. Every “functionally equivalent” piece will pay postage, and the associated contribution of the host subclass. Therefore, the Service should encourage, and not hinder, the development of competing systems.⁵⁶

A further goal is to enter mail into the mailstream that is “clean” and automation compatible. The success of Mailing Online and functionally equivalent systems will increase the volume of automation compatible, clean mail. This mail is not only efficiently handled, but given automation basic rates, is quite profitable. Related to these goals is the necessity to offer competing systems access to the mail delivery system on the same terms available to Mailing Online. Equal access will increase the probability of successfully meeting the first two goals.

The proposed DMCS § 981.23 discusses the rate categories available for mail pieces that cannot be made to meet the Postal Service addressing requirements. These mail pieces are not eligible for any of the automation basic rate categories. Language was added to the proposed text to clarify that these mail pieces can still be mailed if the customer so chooses, but only at the “applicable” single piece rate. The language, as originally proposed, appears to erroneously allow the customer to choose which single piece rate to apply, irregardless of the class of the mail piece.

The proposed DMCS § 981.4 discusses “other special services” that may be available in conjunction with Mailing Online and the underlying subclass of mail chosen by the Mailing Online customer. The specific “other special services” are not enumerated in this section. The Commission recommends that a specific list of services be developed over the course of this experiment. The list of services shall be

⁵⁶ One area that has the potential to cause inequity is the definition of “on average.” Every attempt must be made to apply the term “on average” equally to the Postal Service and to competing systems when implementing the minimum volume requirement.

considered during a permanent request for Mailing Online and the appropriate services included in the DMCS.

The Commission recommends the DMCS language proposed in the Stipulation and Agreement subject to the clarifications and interpretations presented in this opinion. The Commission further suggests that the Postal Service encourage the development of competing systems. The contributions to institutional cost from mail generated by functionally equivalent systems may be substantial. Competing systems may be able to offer a mix of attributes not available from Mailing Online, and it should be in the Service's interest to expand this market as much as possible.

To keep the Commission apprised of the competition seeking functional equivalency, the Commission requests supplemental information to be provided with each data collection report. The information shall include: the identity of the party applying for functional equivalency, the date of the application, the approval date or brief reason for rejection, and a brief status of all pending applications.

As previously noted, the Stipulation and Agreement did not include a discussion of Fee Schedule 981. The Commission has made formatting and substantive changes to the fee schedule proposed in the Request. The fee structure is modified to conform to the recommendations of this Opinion. The text has been edited to remove the term "cost coverage" which could be confused with the Commission's interpretation of that phrase. The format and text was also modified to allow for a description column and a fee column consistent with other special service fee schedules. Finally, text was added to Schedule 1000 to provide for an annual certification fee.

IV. ANTI-COMPETITIVE IMPACT

The stipulation under which functionally equivalent services will be charged the same postage as Mailing Online alleviated the anti-trust problem focused on most in the Docket No. MC98-1 opinion. However in its initial brief, MASA/P11 argues the Commission should not recommend Mailing Online because of the impact that the Mailing Online experiment will have on competition. The testimony of witnesses Schuh and Jurgena are offered as support for the allegation that Mailing Online will have an adverse anti-competitive affect on MASA/P11 members. First, MASA/P11 discusses a prima facie case for analyzing competition, and then proceeds to analyze Mailing Online using the vertical integration/foreclosure, bottleneck/essential facilities and price squeeze theories from anti-trust law. It contends Mailing Online is anti-competitive under each of these standards.

The Postal Service replies that Mailing Online is designed in a way that actually minimizes the negative impacts upon competition and coincidentally fosters the positive aspects of competition.⁵⁷ The Service argues competition is fostered through the private sector printers that contract to provide service to Mailing Online and through the functional equivalency language proposed in the DMCS. Furthermore, Mailing Online targets mailers whose needs currently go unmet.⁵⁸

A. Commission Function

The Commission does not enforce the anti-trust laws—though anti-trust policies, principles, and concepts are often used as a framework for analyzing the competitive nature of a proposed service in setting rates and classifications. Whereas antitrust laws are meant only to protect competition and not the individual competitors, the

⁵⁷ USPS Reply Brief at 3.

⁵⁸ USPS-T-1 at 17.

Commission statutorily is required to also consider both the benefits of competition and the impact the Postal Service products may have on enterprises in the private economy. Section 3622(b)(5) requires the Commission to consider the available alternative means of sending and receiving letters and other mail matter at reasonable costs. "The existence of a specifically competitive-oriented provision such as subsection (b)(5) is the clearest kind of mandate to a ratemaking agency to consider competitive issues."⁵⁹ Of a more general authority for considering competition, section 403(c) states the Postal Service shall not "make any undue or unreasonable discrimination among users of the mails, nor shall it grant any undue or unreasonable preferences to any such users." The Commission is not sitting as an antitrust court, but only using the intellectual framework of antitrust law to consider the competitive impact of a proposed service. Competitive impact is but one of many factors the Commission weighs and balances in setting rates and classifications.

The Commission's approach in analyzing a Postal Service proposal using antitrust law is not meant to minimize the importance of a violation of antitrust law. If an antitrust violation is detected, the Commission may first attempt to remedy the violation by recommending changes to the proposal, and setting appropriate rates and classifications. However, this type of remedy is not always sufficient. When a remedy is not apparent or practical, the Commission will not recommend a Postal Service proposal in which a violation of antitrust law has been detected. In the instant proposal, a violation of antitrust law has not been detected, but the antitrust framework still proves useful in analyzing the competitive effects of Mailing Online.

The Commission recognizes that the Mailing Online experiment does not fit neatly into the typical pattern for antitrust analysis. The relationships among the parties are conceptually difficult to fit into a typical wholesaler, retailer, final customer pattern using antitrust analogies. The Postal Service is not merging with or acquiring printers or

⁵⁹ PRC Op. R83-1 at 13.

telecommunications networks. It is expanding vertically by providing printing services, but the relationships are contractual and of a specified duration. The communications media between the customer and the Postal Service is the Internet, and the communications links between the printers and the Postal Service are provided by third parties under contract. Nevertheless, using an antitrust framework is useful to highlight competitive issues that the Commission needs to consider when recommending rates and classification for Mailing Online.

B. Prima Facie Case

A party must establish a prima facie case to raise a competition-based objection to a rate proposal. In E-COM II, the Commission determined that to establish a prima facie case a party must show:

first, that it participates in the same properly-defined market as the Postal Service offering, and, second, that there is an economically reasonable apprehension of material competitive injury from the challenged proposal.⁶⁰

Brown Shoe Co. v. United States, 370 U.S. 294 (1962) discusses the first factor, a properly-defined market, in the terms of a product market and a geographic market. A properly-defined market must be examined in the context of the area of effective competition.

The 'area of effective competition' must be determined by reference to a product market (the 'line of commerce') and a geographic market (the 'section of the country').⁶¹

The second factor to consider is an economically reasonable apprehension of material competitive injury. Actual injury does not have to be shown. The Commission is more

⁶⁰ PRC Op. R83-1 at 22.

⁶¹ *Brown Shoe Co.* at 324 (discussing the determination of the relevant market necessary to predicate finding a violation of the Clayton Act).

liberal than an antitrust court in examining this factor because the Commission is looking into the future to predict competitive effects and recommend rates that will prevent injury, whereas an antitrust court is solely looking for a violation of the antitrust law.

MASA/PII presents its prima facie case through the view of two MASA members, witnesses Schuh and Jurgena. Also relative to the discussion is a description of the organizations that MASA/PII represents. MASA is a trade association of approximately 500 members.⁶² PII is a trade association of approximately 2000 small printers and copy shop members.⁶³

Witness Schuh, a MASA member, is President of the Lloyd Schuh Company, Inc. (LSC).⁶⁴ LSC is a direct mail production company that offers data processing, laser printing, lettershop, and fulfillment services, including the production and preparation of materials for direct mail advertising and communications.⁶⁵ Witness Schuh's testimony expresses concern that Mailing Online will interfere with fair competition and describes the effects on businesses similar to his.

LSC serves small to mid-size clients with the majority of the clients sending 1,000 to 5,000 pieces per mailing. Sixty percent of LSC's jobs are 5,000 pieces or fewer accounting for 30 percent of total revenues. Witness Schuh notes that Mailing Online is intended to target small mailings of no more than 5,000 pieces. Witness Schuh surveyed 14 other mail shops and found small mailings accounted for an average of 58 percent of their jobs and 35 percent of their total revenue.⁶⁶

⁶² Notice of Intervention by Mail Advertising Service Association International, November 29, 1999.

⁶³ Notice of Intervention by PrintImage International, December 15, 1999.

⁶⁴ Witness Schuh's testimony was designated from Docket No. MC98-1 and appears in the MC2000-2 transcript at Tr. 4/820-36.

⁶⁵ Tr. 4/822.

⁶⁶ Survey results titled: USPS Mailing Online Business Partner Statistics. Tr. 4/834.

Witness Schuh alleges several examples of the competitive advantages that the Postal Service holds over businesses like his. The sheer size of the Postal Service means companies like his cannot compete with the Service's advertising and promotional activities. LSC does not have access to the Postal Service's sensitive business information identifying permit holders and data related to their usage patterns. Automation basic rates will be offered to Postal Service customers irrespective of the size of their mailings. The Postal Service is exempt from state and local sales taxes. The LSC non-postal costs run from 50 percent to 250 percent higher than the Postal Service's non-postal costs.⁶⁷ A significant part of LSC's costs are associated with its interaction with clients. Mailing Online may have unrealistically disregarded the real cost of providing service to the customer. Schuh contends these factors may cause his firm to lose business to Mailing Online.

Witness Jurgena, a MASA member, is President of Mail Advertising Services, Inc. (MAS).⁶⁸ MAS is a direct mail production company that offers services including maintenance of mailing lists, conversion of lists from multiple formats, personalization of letters, labeling of envelopes and other mail-related functions. MAS does not offer printing.⁶⁹ Witness Jurgena's testimony describes the impact Mailing Online may have on his business and the unfairness of competition with the Postal Service.

Sixty-five percent of MAS's jobs are 5,000 pieces or fewer accounting for 30 percent of total revenues. MAS's average job size is 7,000 to 8,000 pieces. Larger jobs are frequently split into multiple jobs of fewer than 5,000 pieces. Witness Jurgena notes that Mailing Online is also intended to target small mailings of 5,000 pieces or fewer.

⁶⁷ Lloyd Schuh Company Pricing Comparison on USPS Detailed Calculations of Costs for Exhibit A. Tr. 4/835.

⁶⁸ Witness Jurgena's testimony was designated from Docket No. MC98-1 and appears in the MC2000-2 transcript at Tr. 4/847-58.

⁶⁹ Mailing Advertising Services' customer base includes printers. Tr. 4/849.

Witness Jurgena identifies several examples of the competitive advantages that the Postal Service holds over businesses like his. Automation basic rates will be offered to Mailing Online customers irrespective of the size of their mailings. Even though the Postal Service is targeting small offices and home offices, larger corporations also send small mailings. Larger corporations have sufficient sophistication and technical ability to transmit mailings directly to Mailing Online. This, combined with the lower postage rates, will make it difficult for MAS to persuade the larger customers to continue using its services. The Postal Service has far greater resources than MAS for advertising on a national level. Witness Jurgena is concerned with the competitive use of information that MAS must provide to the Postal Service when entering mail. Finally, witness Jurgena argues, as does witness Schuh, that the level of customer interaction necessary, along with the associated costs has been underestimated by the Postal Service.

The Commission now turns to the Postal Service description of Mailing Online. Mailing Online will be available nationally, through USPS.com. Mailing Online targets smaller customers, even mailers of individual pieces.⁷⁰ Many of the customers will be drawn from the small office/home office (SOHO) market as opposed to larger mailers who have access to deeper discounts than basic automation presort. Lettershops themselves may find Mailing Online's attributes suited to specific mailings.⁷¹ Mailing Online targets mailers whose current needs go unmet. Mailing Online does not provide the high level of customization, capabilities, and customer interaction that other services provide. MASA members services do not feature the convenience of initiating a mailing

⁷⁰ Request at 4.

⁷¹ USPS-T-1 at 17.

through a single web site visit or claim to attract technology savvy small mailers.⁷² The flat rate pricing inherent in digital print technology does not lend itself to larger jobs.⁷³

The first factor to consider is whether the competition participates in the same properly-defined market as the Postal Service offering. The product market will be examined first followed by the geographic market. The Postal Service claims to be targeting smaller mailings where digital printing technology has an advantage. This may not impact the MASA/PII members that target larger mailings because MASA/PII members are not limited by digital printing technology and may utilize deeper discounts in postage than those proposed by Mailing Online. MASA/PII argues that, according to witness Schuh's survey, a majority of the surveyed MASA member jobs are in the small mailing category. The Postal Service, however, will even prepare and mail a single mailpiece at the same relative price. It is doubtful that single piece mailings are economically practical for a typical MASA/PII member. Using these facts alone, the product market may be defined as preparing "smaller" mailings for entry into the mail stream. Examining the other facts in the record lead the Commission to believe that this is probably an over inclusive definition.

The Postal Service offers only a limited number of options to the customers. There are limited paper and envelope sizes, types and colors. The printing options are initially limited to black and white, and spot color. These limits may not apply to typical MASA/PII members that may provide high levels of customization. This distinction is less important to the Commission because it assumes that the Postal Service will improve, over time, the options being offered.⁷⁴

⁷² USPS Reply Brief at 10.

⁷³ The record is replete with multiple examples of Mailing Online features used in formulating this market description. The Commission compiled the market description from reviewing the record and considers it a representative sampling of the Postal Service's description of Mailing Online.

⁷⁴ For instance, the Postal Service is already discussing the possibility of offering full color.

The MASA/PII witnesses criticize the Postal Service for underestimating the level of customer service required. The Postal Service claims to target technology savvy customers that seek convenience and do not require a high level of customer service. The Commission views customer service as an important distinction between Mailing Online and the alleged competition. Customer service is an important part of the product being offered by witnesses Schuh's and Jurgena's businesses that Mailing Online does not offer. This may also account for a portion of the higher prices being charged by their businesses.

Another aspect of customer service that is not adequately discussed on the record is the level of assistance in designing the mailpiece to be printed. The Postal Service is not offering this type of assistance. The Commission can safely assume that even if MASA/PII members do not offer mailpiece design as a service, they will assist the customer in locating a provider of this service.

Mailing Online is offered through the Internet. MASA/PII does not allege this to be a major feature offered by its members. This focuses on another possible definition of the product market: "electronic entry and preparation of mail for delivery to the Postal Service with entry into the mail stream." This is much more restrictive than the broad view that the product market may be defined as preparing "smaller" mailings for entry into the mail stream. The more restrictive definition of the product market is bolstered by the existence of services such as www.ELetter.com.⁷⁵ Upon cursory review, this service appears to be in the same product market as Mailing Online. It offers electronic entry and preparation of mail for delivery to the Postal Service with entry into the mail stream (including some automation basic rates).

The Commission concludes that the more proper product market definition is the restrictive definition suggested above. Although some record evidence exists to assist the Commission in defining the product market, the issue was not directly litigated in

⁷⁵ USPS-T-1 at 18.

this proceeding and will have to be further developed during a permanent request for Mailing Online. For the purpose of this opinion on the experiment, the Commission assumes some indirect competition between MASA/PII members and Mailing Online.

Competition, either direct or indirect, can be beneficial to the marketplace. To this extent, antitrust laws are designed to foster fair competition. They should not be applied to protect individual competitors. Businesses that experience competition will become more efficient and evolve with changing business conditions to offer new and improved products to the marketplace. The consumer also benefits from the variety of products offered and the efficient pricing caused by competition. Mailing Online has the potential to conveniently offer a beneficial product to the general public. The product, including the access method to obtain the product, was previously unavailable at such a reasonable price. Mailing Online may indirectly compete with other mail preparation services, but this competition will only add to the variety of products available in the marketplace.

The Commission is cognizant that competition with the Postal Service is different from competition in the open marketplace. The Postal Service has great economic power and vast resources at its disposal in comparison to most, if not all, potential Mailing Online competitors. It has a statutory requirement to financially break even, but does not have a requirement to ever produce a profit. The break-even requirement is system wide, not on a product by product basis.⁷⁶ The Postal Service also has a statutory mail delivery monopoly. The institutional contributions derived from the monopoly products give the Postal Service the freedom to venture into experimental services. The above allows the Postal Service to take financial risks that would be otherwise unacceptable in the private sector.

⁷⁶ Mailing Online is an experiment that potentially may fail. The requirement that each class of mail or type of mail service bear the direct and indirect postal costs attributable to that type plus that portion of all other costs of the Postal Service reasonably assignable to such class or type cannot retrospectively influence a discontinued experiment that has failed. § 3622(b)(3).

For example, Mailing Online printer contracts contain minimum payment provisions irregardless of volume. Adequate volume was not realized during the market test, and the Postal Service paid a substantial penalty to the market test printer.⁷⁷ The experiment is planning on 25 printers with 25 contracts containing the minimum payment provision. If Mailing Online fails to produce the anticipated minimum volumes, this might become a substantial institutional expense. A private enterprise sustaining a similar loss might be in jeopardy of going out of business. The other effect of the minimum payment is to allow the Postal Service to secure a favorable printing price based on a guaranteed high volume of printing. The result is printer prices below what the competition can offer. MASA/PIL alleges the Postal Service's printer price advantage may result in Mailing Online being priced below the costs incurred by competing printers.⁷⁸ Therefore, the Commission cannot dismiss the potential for harm caused by indirect competition with the Postal Service.

There are two perspectives to analyzing the geographic market. The first is where does a supplier offer products for sale to a customer and the second is where does a customer look to purchase products from a supplier. Mailing Online is offered for sale nationally due to its Internet presence.⁷⁹ Assumptions have to be made about where MASA/PIL members offer their products for sale. The assumptions will not affect the analysis of competitive issues in this case. MASA/PIL membership ranges in the low thousands. Given this large number of businesses and the description of witnesses Schuh's and Jurgena's businesses, the Commission assumes, noting the record is not developed, the MASA/PIL membership is geographically dispersed nationwide. Furthermore, the majority of the businesses probably offer their service locally, with a

⁷⁷ The Postal Service had the option to provide other non-Mailing Online work to the printer in place of the Mailing Online minimum volume. The Postal Service did not exercise this option.

⁷⁸ MASA/PIL Brief at 16-17.

⁷⁹ Through its Internet presence, Mailing Online may actually be available internationally. The record is not developed as to the impact that this may have.

smaller number of businesses offering services regionally. A limited number of businesses may sell at the national level. This would indicate the geographic area where Mailing Online offers services may encompass the geographic area of where the MASA/PII membership offers its services. What is not clear is the level of interest that a typical MASA/PII member has in offering products for national distribution as does Mailing Online.

The MASA/PII witnesses testify that their businesses cannot compete with the Postal Service in advertising. Advertising may be another indication of the geographic market of a product assuming that a business would only advertise in the geographic market it is attempting to reach. The record is not developed enough to indicate a relationship between advertising and geographic market.

Analyzing where the customers look to purchase products offered by Mailing Online or by the competition raises interesting questions that are not adequately answered in the record. The Commission assumes the customers that seek the services offered by Mailing Online may come from anywhere in the nation. The question that is not answered in the record is the characteristics of the customers that seek services from MASA/PII members. It is not clear whether the customer of a typical MASA/PII member will look to purchase a product from a service not within the customers local or regional area, and it is not clear whether a Mailing Online customer that perceives Mailing Online as a nationally available service would consider the services of a MASA/PII member that may typically do business within a local or regional area as a viable alternative. The true geographic market cannot be determined given the record in this docket.

The second factor to consider to establish a prima facie showing is that there is an economically reasonable apprehension of material competitive injury from the challenged proposal. Because of the limited nature of the Mailing Online market test and because Mailing Online is yet to be an operational service, there is no record

evidence of actual competitive injury occurring. MASA/P11 has presented two witnesses that apprehend material competitive injury from Mailing Online. The record is not adequate to determine if this is a reasonable apprehension, pure speculation, or a general concern that competition caused by anyone entering the mail preparation business is bad for the member's business. Furthermore, there is no showing that the apprehension expressed by the two witnesses is representative of a majority of the members of the properly defined market.

The prima facie case presented by MASA/P11 is not well developed. The Commission is skeptical of the more inclusive view inferred from the MASA/P11 argument that the product market is preparing "smaller" mailings for entry into the mail stream. The geographic market of where customers are looking for a supplier and where suppliers are looking for customers requires even more development. This all relates to the question of what is the characteristic of the intended customer that each service is attempting to reach. MASA/P11 has demonstrated that two members apprehend competition from Mailing Online. There is no way to judge if this is a reasonable apprehension.

The Commission does assume there will be some indirect competition between MASA/P11 members and Mailing Online. The level of competition cannot be reliably estimated. In a permanent request for Mailing Online, the prima facie case must be developed to a greater extent. However, the Commission considers the impact upon competition an important issue. The MASA/P11 brief does reveal important concerns in its discussion of antitrust issues. Therefore, even though the prima facie case is weak, the Commission will continue analyzing Mailing Online using the anti-trust framework in order to uncover other issues that may be considered now in setting rates and classifications.

C. Vertical Integration of Delivery and Production of Mail

MASA/PII urges the Commission to analyze Mailing Online using the factors that indicate an anti-competitive effect resulting from a vertical acquisition enumerated in *United States Steel Corp. v. Federal Trade Commission*, 426 F.2d 592 (6th Cir. 1970). MASA/PII alleges that this will establish there is in fact vertical foreclosure, and that it is accomplished by anti-competitive means.⁸⁰ *United States Steel Corp.* analyzes vertical acquisitions utilizing the following six factors as an indication that a vertical acquisition has the prerequisite anti-competitive effect for violation of the Clayton Act:

(1) foreclosing of the competitors of either party from a segment of the market otherwise open to them; (2) the 'nature and purpose' of the vertical arrangement; (3) actual and reasonable likely adverse effects upon local industries and small businesses; (4) the level and trend of concentration in the market shares of participating companies, including any trend towards domination by a few leaders; (5) the existence of a trend towards vertical integration and consolidation in previously independent industries; and (6) the ease with which potential entrants may readily overcome barriers to full entry and compete effectively with existing companies.⁸¹

The Commission will review each of the six factors to look for indicia of an anti-competitive nature to Mailing Online. It recognizes that although Mailing Online concerns a vertical arrangement, a vertical acquisition is not involved. The Commission only uses the six factors as a framework for analysis in fulfillment of its statutory requirement to consider the competitive effects of Mailing Online.

Foreclosure. MASA/PII argues Mailing Online will foreclose MASA/PII members from the market, i.e., from the customer base that Mailing Online captures.⁸² This portion of the SOHO market represents millions of mailpieces each year. Moreover, if

⁸⁰ MASA/PII Brief at 10.

⁸¹ *United States Steel Corp.* at 599.

⁸² MASA/PII Brief at 10.

the Postal Service enhances the options offered to Mailing Online customers, Mailing Online volumes will likely grow. This will increase the extent of the market foreclosure.

The MASA/PII arguments do not comport with the Commission's understanding of foreclosure. When arguing foreclosure, MASA/PII does not allege that its members are foreclosed from offering a functionally equivalent Mailing Online service or that its members are foreclosed from using the Postal Service for delivery of mail on comparable terms with Mailing Online. MASA/PII argues that because of the perceived competitive advantage that Mailing Online may possess, the MASA/PII customer base may be drawn to Mailing Online. There is no evidence of any arrangement between the customer base and the Mailing Online printers or the Postal Service foreclosing the customers from using any other service to generate or enter mail. If customers are drawn to Mailing Online, it will be due to features like price, service, or product offerings. This is competition, not foreclosure. Whether the competition is fair or unfair is another issue unrelated to foreclosure.

Nature and Purpose. MASA/PII cites the following examples of the nature of the competitive advantage that Mailing Online will have over the competition: The exemption from minimum quantity requirements for automation discounts gives Mailing Online an advantage for the duration of the experiment. The terms for functional equivalency stifles competition and gives the Postal Service control over the competition. Mailing Online provides free address list cleansing and FastForward that places the Postal Service at a competitive advantage. The Postal Service possesses a cost, resource and customer base advantage. The Postal Service possesses institutional advantages such as exemption from sales tax, freedom from making a profit, and access to customer information.⁸³

The Commission discusses the competitive advantages alleged by MASA/PII throughout this Opinion partly because the issues were raised in the context of this

⁸³ *Id.* at 12-17.

antitrust analysis. However, these issues do not support a “nature and purpose” argument. MASA/PII have presented no evidence to support a contention that the purpose of any attribute of Mailing Online is to exclude competition. Thus, the Commission does not focus on the purpose or intent side of this factor. The Commission focuses on the nature side of the argument because this will provide insight into the competitive aspects of the vertical arrangement. The nature of the Mailing Online arrangement is a limited duration contract with multiple suppliers of telecommunications, computer, software, and most importantly printing services. It does not appear to be a permanent restructuring of any customer-supplier market. For instance, the elements of a long-term “exclusive-dealing” contract or a “tying” contract have not been alleged.

Actual Effects on Local Business. MASA/PII acknowledges that there is as yet no actual adverse effect on small business because, except for the market test, the Mailing Online system is not operational.⁸⁴ MASA/PII argues there will likely be future adverse effects upon local industries and small businesses. The adverse effects will be due to the Postal Service’s lower non-printing costs, virtually unlimited budget for advertising and development, informational data base concerning the users of the mails and lower Mailing Online postage rates. This will result in loss of existing business in the short-run market segment. MASA/PII relies on a survey provided by witness Schuh that showed jobs under 5,000 pieces account for one-half of the survey respondents jobs and one-third of their revenues. MASA/PII theorizes that the loss of one-third of this market segment will decrease the business revenues by 10 percent, which if not fatal, will be keenly felt by many of the businesses.

The Postal Service alleges differences in the service offered between Mailing Online and those offered by MASA/PII members.⁸⁵ Potential users of Mailing Online

⁸⁴ *Id.* at 18-19.

⁸⁵ USPS Brief at 17-18.

are not well served by the current industry, thus there is little reason to believe their businesses will be negatively impacted. The Postal Service claims that Mailing Online should offer new growth opportunities for other service providers.

The Rothschild survey shows Mailing Online attracting some current mail, and it is reasonable to assume there will be some effect on local printing businesses. The record does not adequately quantify the probable effect on local businesses or the overall industry. Although the record does show the apprehension of competition by two MASA members, no actual adverse effect has been shown at this time.

In the *prima facie* case discussion, the Commission recognized that competition with the Postal Service is different than competition among businesses in the private sector. The sheer size and economic strength of the Postal Service, along with government backing, allow the Postal Service to take risks that a private enterprise would find unacceptable. The ability to purchase in large volume gives the Postal Service an advantage of being able to offer lower prices for its services. Mailing Online proposes a new vertical arrangement between the Postal Service and a portion of the printing industry. The Commission assumes that when an entity as large as the Postal Service enters into a new arena, the printing industry, the Postal Service will in some way affect the market. This in turn will effect local businesses, such as MASA/PII members, that are involved with the printing industry.

Concentration. The level and trend of concentration in the market shares of participating companies, including any trend towards domination by a few leaders is the fourth factor. "Any increase in concentration in industries whose concentration levels are already 'great' is alarming because such increases make so much less likely the possibility of eventual deconcentration."⁸⁶ There is no record evidence or argument on brief of this factor.

⁸⁶ *United States Steel Corp.*, 426 F.2d 592, 602 (citing *United States v. Philadelphia National Bank*, 374 U.S. at 365 n. 42).

Vertical Integration. The existence of a trend towards vertical integration and consolidation in previously independent industries is the fifth factor. There is no record evidence or argument on brief of this factor.

Barriers to Entry. MASA/P11 discusses several alleged advantages that Mailing Online has that when combined with the three-year duration of the experiment will make it impossible for the competition to catch up.⁸⁷ The waiver of the automation basic minimum requirement, the restrictive definition of functional equivalency, free address cleansing and FastForward, lower printing and advertising costs, and the substantial resources available to the Postal Service are cited as Mailing Online advantages.

At this time, the Commission does not find convincing evidence of a substantial barrier to entry. A service similar to the proposed Mailing Online, www.ELetter.com, exists today. ELetter does not take advantage of the functional equivalency language, but still offers automation basic rates with no minimums.⁸⁸ When the Commission was considering the market test, Pitney Bowes argued that there were several other existing electronic/postal services, including the Pitney Bowes DirectNet service, that were functionally equivalent to Mailing Online.⁸⁹ Other services may decide to operate using the functionally equivalent language on the same terms as Mailing Online, or may qualify for even deeper discounts under some other system of operation. The claims of free address cleansing, free FastForward and advertising costs are discussed in the Attributable Mailing Online Costs and Non Postage Mailing Online Pricing sections of this Opinion. The printing costs are determined by contracts with private entities. The record does not support a claim of barrier to entry into this market.

⁸⁷ MASA/P11 Brief at 19-20.

⁸⁸ USPS-T-1 at 18.

⁸⁹ PRC Op. MC98-1 at 18-20. When the market test was under consideration, Pitney Bowes argued that the Postal Service was giving itself a competitive advantage by not making available to other functionally equivalent systems the exemption from minimum volume requirements. In this docket, Pitney Bowes has signed the Stipulation and Agreement that provides the exemption from the minimum volume requirements and a definition of functionally equivalency in the DMCS.

Conclusion. The Commission has analyzed Mailing Online using a vertical integration/market foreclosure framework. Market foreclosure or a substantial barrier to entry is not apparent on the record, nor does the record show the nature of the arrangement to be suspect. However there may be some effect on local businesses due to the nature of the vertical arrangement. The analysis is beneficial in that it reveals several competitive concerns that will be taken into account when setting rates for this service.

D. Unlawful Bottleneck

"[T]he essential facilities doctrine imposes liability when one firm, which controls an essential facility, denies a second firm reasonable access to a product or service that the second firm must obtain in order to compete with the first."⁹⁰ "Such a refusal may be unlawful because a monopolist's control of an essential facility (sometimes called a "bottleneck") can extend monopoly power from one stage of production to another, and from one market to another."⁹¹

MASA/P11 urges the Commission to analyze Mailing Online using the factors enumerated in *MCI Communications Corp.* that indicate if an essential or bottleneck facility is unlawfully anti-competitive. MASA/P11 asserts applying these factors will establish the Postal Service will effectively deny the use of an essential facility.⁹² *MCI Communications Corp.* analyzes the possible anti-competitive features of a bottleneck facility utilizing the following four factors of the essential facilities doctrine:

(1) control of the essential facility by a monopolist; (2) a competitor's inability practically or reasonably to duplicate the essential facility; (3) the

⁹⁰ *Alaska Airlines, Inc. v. United Airlines, Inc.*, 948 F.2d 536, 542 (9th Cir. 1991).

⁹¹ *MCI Communications Corp. v. American Telephone and Telegraph Company*, 708 F.2d 1081, 1132 (7th Cir. 1982).

⁹² MASA/P11 Brief at 24.

denial of the use of the facility to a competitor; and (4) the feasibility of providing the facility.⁹³

MASA/PII focuses on the third factor—denial of use.

The court in *Delaware & Hudson Railway Co. v. Consolidated Rail Corp.*, 902 F.2d 174, 179-80, explains denial of use by stating: “[T]here need not be an outright refusal to deal in order to find that denial of an essential facility occurred. It is sufficient if the terms of the offer to deal are unreasonable.” MASA/PII’s alleges, in comparison to Mailing Online, its members’ use of the Postal Service is on a discriminatory or unreasonable basis. The discrimination is caused by the Postal Service’s exemption from the automation basic minimum requirements, provision of free address list cleansing service, provision of free FastForward service, and pricing deficiencies within the Postal Service cost analysis for Mailing Online. Because of the Mailing Online discriminatory features, the Postal Service has created an unlawful bottleneck. MASA/PII argues that to alleviate the discrimination, the Postal Service must eliminate automation basic minimum requirements for its competitors, provide free address list cleansing service, eliminate charges for FastForward, and correct the price deficiencies within its cost analysis.

The Postal Service challenges the application of the second and third factors of the essential facilities doctrine.⁹⁴ The “inability practically or reasonably to duplicate the essential facility” factor is challenged because there are alternate delivery networks available. The Postal Service states: “the Postal Service does not have a monopoly on delivery services; if it did competitors like UPS, FedEx, and many others would not exist.”⁹⁵ The “denial of use” factor is challenged because competitors may use the

⁹³ *MCI Communications Corp.* at 1132-33.

⁹⁴ USPS Reply Brief at 4.

⁹⁵ *Id.* at 3.

Postal Service delivery network via Mailing Online, via a functionally equivalent service, or via traditional methods.

The Commission finds the Postal Service's argument that it does not have a monopoly on delivery services disingenuous. The issue is not all delivery services, but letter delivery services, which are statutorily established as a Postal Service monopoly by the Private Express Statutes.⁹⁶ The Postal Service denial of use argument also misses the point by not directly addressing the MASA/PII allegation of denial of use by unreasonable or discriminatory terms. The Postal Service argues there is not a denial of use because of the alternate methods available for entering the delivery system.

The Commission does not find the MASA/PII unlawful bottleneck argument compelling either. MASA/PII does not argue that the Postal Service will deny outright use of an essential facility, it argues denial of use because of unreasonable or discriminatory terms. Each of the alleged discriminatory terms are addressed in this Opinion. In each case where problems are found, either corrective recommendations are given or the terms are shown to be temporary in duration or limited in impact.

To summarize, the costs of address cleansing and FastForward are included in pricing Mailing Online and the price deficiencies with the Postal Service cost analysis are brought into conformance with Commission standards. Furthermore, the exemption from the automation basic minimum requirement is considered temporary in duration, and limited in impact. When the Postal Service attains the predicted volumes, the Service should exceed the depth of presort minimum requirement within batchings. After this point in time, the issue of the exemption becomes mute. If the predicted volumes are not attained, the impact is self-limiting to the amount of mail entered and the duration of the experiment. The functional equivalency language in the DMCS will allow competitors the same exemption from the minimum volume requirements as is available to the Postal Service if their volume should, on average, meet the minimum

⁹⁶ See 18 U.S.C. §§ 1693-99, 39 U.S.C. §§ 601-606.

requirements. The initial ramp-up period for meeting the on average requirement is also addressed. Competitors may also access the facility using more advantageous rates than Mailing Online by qualifying for deeper discounts. The unlawful bottleneck framework for analysis did not reveal an anti-competitive problem with Mailing Online, but was useful in identifying several issues that needed to be addressed in this Opinion.

E. Price Squeeze

A price squeeze may occur “if a firm has a wholesale monopoly and wishes to extend that to the retail level, where it has competition, it might raise its wholesale prices to the point that others cannot compete with it at retail.”⁹⁷ MASA/P11 alleges the existence of a bottleneck facility, the accompanying price discrimination, and the Postal Service’s institutional cost advantage gives rise to a price squeeze.⁹⁸ The same arguments in support of an unlawful bottleneck are used to support this argument. MASA/P11 further attempts to draw similarities between Mailing Online and E-COM II where price squeeze conditions were present.

In the Mailing Online Market Test Opinion and Recommended Decision, Docket No. MC98-1 at 25, the Commission distinguished the facts and alleged discrimination of E-COM II from Mailing Online.

The conclusions that the Commission reached concerning the alleged mailstream price discriminations in E-COM II are not controlling with respect to Mailing Online. Those conclusions depend to a large degree on the Commission’s findings as to the specific competitive circumstances of that case. Though similar, the facts in E-COM II are not parallel to those in the Postal Service’s proposed Mailing Online rate design. The conceptual unbundling of mailstream charges from non-mailstream charges in E-COM II involved ascribing an implicit mailstream cost to E-COM. The mailstream price that the Postal Service proposes to charge Mailing Online is an explicit price. But, as in the E-COM II result, the

⁹⁷ *City of Anaheim v. Southern California Edison Co.*, 955 F.2d 1373 (9th Cir. 1992).

⁹⁸ MASA Brief at 24.

Commission regards the underlying economic reality, not the legal form of the pricing proposal, to be controlling when evaluating assertions that rates are unduly discriminatory in form, and unreasonable anticompetitive in effect.

The remedy in E-COM was to “unbundle” the pricing, and separately analyze and price the mail preparation and mail delivery portions of the service. Mailing Online prices as proposed are already unbundled and do not suffer the same infirmities as in E-COM.

MASA/PII again raises exemption from the automation basic minimum requirements, provision of free address list cleansing service, and provision of free FastForward service as factors in support of the price squeeze argument.⁹⁹ The Commission is separately addressing these issues. Record evidence relating or discussing the magnitude of a price squeeze to the factual issues raised by MASA/PII would have aided the Commission in this analysis. However the record is not developed in discussing the magnitude of an alleged price squeeze nor does it provide adequate supporting evidence or argument for a price squeeze analysis.

The Commission concludes that there is insufficient evidence to indicate the presence of a price squeeze. The facts surrounding Mailing Online were previously distinguished from the facts in E-COM II, which fit the pattern of a price squeeze. The proposed functional equivalency language in the DMCS and the option of entering mail at deeper discounts than offered by Mailing Online make the possibility of a price squeeze less likely.

F. Summary

The Commission has reviewed Mailing Online within the framework of vertical integration/foreclosure, unlawful bottleneck/essential facilities doctrine, and price squeeze analysis. The Commission’s interest in the analysis is to explore the

⁹⁹ *Id.* at 26.

competitive impact of Mailing Online. To this extent, many factual issues are raised concerning services offered, pricing, and competition that will be considered, and corrections recommended where necessary, when setting rates for Mailing Online.

V. ATTRIBUTABLE MAILING ONLINE COSTS

Postal Service witness Takis argues that only costs caused by the Mailing Online experiment should be allocated to the experimental service. Such caused costs constitute the incremental costs, which should be covered by the projected experiment revenue. Witness Takis also discusses how incremental costs are separated into volume variable costs and product specific costs.¹⁰⁰ Witness Lim calculates the information technology costs for the pre-experiment period and each year of the experiment.¹⁰¹ Witness Poellnitz, using witness Lim's calculated costs, separates the information technology costs into volume variable and product specific costs. Witness Poellnitz uses a budget number for the product specific advertising costs.¹⁰² The Postal Service treats only volume variable printer and information technology costs as attributable.¹⁰³ Witness Plunkett explains that the product specific costs are treated as incremental, and argues that such costs are not attributable since they are non-recurring.¹⁰⁴ MASA/PII and OCA argue that all costs that can be identified as product specific to Mailing Online, should be attributed to Mailing Online consistent with the Commission's R97-1 cost methodology.¹⁰⁵

MASA/PII and the OCA believe that there are additional product specific costs beyond those that the Service identifies. They argue that costs from the operations and market tests of Mailing Online may be considered as product specific to Mailing Online. Also, MASA/PII claims that the Commission should include credit card fees, revenue leakage and some part of joint and common advertising costs already incurred. Table 1

¹⁰⁰ USPS-T-4 at 4-7.

¹⁰¹ USPS-T-3, Workpapers A-E.

¹⁰² *Id.*, USPS-T-2, Exhibit A, Tables 6-7.

¹⁰³ USPS-T-5 at 5-6.

¹⁰⁴ *Id.* at 7.

¹⁰⁵ MASA/PII Brief at 30, OCA Brief at 9-11.

contains a summary of costs that either the Postal Service, MASA/P11 and/or OCA propose to be treated as attributable for the three years of the Mailing Online experiment.

Table 1: Proposals of USPS, MASA/P11, and/or OCS for Attributable Costs

Cost Type	Costs In \$	Source
Printer Costs	348,198,720	USPS-T-5, Exhibit D (Corrected)
Volume Variable Information Technology (IT) Costs	4,811,765	USPS-T-5, Exhibit D (Corrected)
Product Specific IT Costs	30,303,918	USPS-T-5, Exhibit D (Corrected)
Advertising Cost Budget	2,175,000	USPS-T-5, Exhibit D (Corrected)
Additional Advertising costs - beyond budget \$725,000 per year	No specific suggestions	OCA Brief at 20-22
Market Test/Operations Costs not accounted for in Product Specific Costs		
Printer Minimum Payment	251,867	MASA Brief at 39 and Tr. 2/274
Printer Minimum plus costs from Market Test Data reports	1,688,829	OCA Reply at 13, fn. 38
Joint and Common Advertising costs	Portion of 4,674,932	OCA Reply Brief at 13, fn. 40
Credit Card Fees (Max. 3% of sales, MASA uses as proposed cost)	13,767,409	MASA/P11 Brief at 38
Additional Help Desk Costs beyond \$3,515,765 USPS proposes	No specific suggestions	MASA/P11 Brief at 35-36
Revenue Leakage (MASA estimate)	43,100,000	MASA/P11 Brief at 39
Total Possible	448,972,440	

The following sections summarize the cost positions of the parties along with the Commission's analyses and recommendations.

A. Printer Costs

Printers will be competitively selected and placed under contract with the Postal Service. The printers will transform Mailing Online jobs in electronic format into hardcopy mail and enter the mail into the mail stream. The contracts will contain unit prices for every type of Mailing Online product to be offered to the public. Witness Poellnitz develops estimates of the printer unit costs for the Postal Service. The unit costs are multiplied by the volume estimates developed by witness Rothschild to obtain

the total printer costs over the three years of the experiment.¹⁰⁶ In MC98-1, and in this docket, MASA/PII, OCA, and Pitney Bowes question the reliability of the Rothschild estimates. The Commission accepts the Service's claim that the Rothschild projections may be utilized as the best available estimate of expected Mailing Online volumes during the experiment until actual customer reaction is experienced.¹⁰⁷

All parties treat total printer costs as fully volume variable, and therefore attributable. The Commission accepts the Service's characterization of the printer contract costs as 100 percent volume variable, but notes that these product specific costs might be attributable even if they are not volume variable. It may be worth exploring whether there are some fixed costs included in the total printer costs by performing a functional analysis of the contracted activity. Certainly, the \$251,867 minimum previously paid to the printer in the Mailing Online market test was caused by Mailing Online, but it might not be viewed as volume variable. In future considerations of any permanent request for Mailing Online, the issue of how to treat contract printer costs should be examined.

B. Volume Variable Information Technology Costs

Witness Lim identifies \$4,811,764 of costs involved in the obtaining, processing and transmitting to the printers the Mailing Online mailings. These costs are for the help desk and the rental of communication links. The Postal Service considers them to be information technology costs that vary with volume.¹⁰⁸ The amount and treatment of these costs are not disputed by the parties and the Commission will treat them as attributable.

¹⁰⁶ USPS-T-2 at 7-13, Exhibit A. The volume estimates are from witness Rothschild's testimony originally presented in MC98-1 and re-introduced in this docket. Docket No. MC98-1, USPS-T-4.

¹⁰⁷ See Section B(b) of this Opinion.

¹⁰⁸ USPS-T-2, Table 6 at 6.

C. Product Specific Technology and Advertising Costs

Witness Plunkett identifies \$30.3 million in costs the Service treats as non-volume variable but product specific to Mailing Online. These include \$9.6 million in pre-experiment information technology development and implementation costs; \$20.7 million in development and implementation costs to be incurred during the three years of the experiment, and \$2.2 million budgeted for advertising.¹⁰⁹ The parties do not challenge the information technology costs and agree that the \$2.2 million advertising budget is product specific to Mailing Online.

OCA is concerned that such a low advertising budget may be detrimental to the success of Mailing Online, and may hinder the generation of the volumes projected from the Rothschild survey.¹¹⁰ MASA/PII characterizes the Service's marketing decisions as "misguided at best and almost guarantee that the Postal Service will fail to achieve its objectives."¹¹¹

The Postal Service argues that these product specific costs should not be treated as attributable on the grounds that they do not vary with volume and, in part, are for products that will be useful beyond the experimental period. Therefore, the Mailing Online users during the experiment should not fully bear the burden of recovering the development and implementation costs. The Service singles out the \$9.6 pre-experiment product specific costs as exempt from being treated as attributable on the grounds that they are not even incurred during the experimental period.¹¹²

OCA and MASA/PII argue that Commission precedent is to attribute product specific costs. Furthermore, MASA/PII argues that the Service has not made a case as

¹⁰⁹ USPS T-5 Table 6 (corrected).

¹¹⁰ OCA Brief at 20-22.

¹¹¹ MASA/PII Reply Brief at 6.

¹¹² USPS Reply Brief at 12.

to what part of the product specific costs should be amortized over a longer period, especially considering the rapidly changing internet-related technology market.

The Commission did treat product specific costs as attributable in R97-1 and continues that practice in this docket. Certainly all the identified product specific costs would be avoided if the experiment was not occurring or not been planned to occur.

The OCA and MASA/PII concerns about the advertising budget being too low are reasonable. However, setting the budget for such discretionary items is the responsibility of the Postal Service. On reply brief, the Postal Service asserts that "the best available projection for advertising expenses has been used."¹¹³ Additionally, the Service cites witness Plunkett's plans for maximizing the return on advertising expenditures by targeting customers and by using the media to communicate with potential customers in ways that are not considered advertising.¹¹⁴ Given these assertions, the Commission accepts the Service's advertising budget as the best available estimate for advertising costs during the experiment. In any future request for permanent Mailing Online service, the entire marketing expenditures, including joint and common advertising costs, should be thoroughly examined to determine exactly what should be attributed in the future. Therefore, the data collection plan being recommended requires the Service to report both Mailing Online specific advertising costs and costs of all marketing efforts which involve Mailing Online along with other products.

D. Mailing Online Market and Operations Test Expenses

The OCA and MASA/PII argue, on brief, that expenses not recovered from the Mailing Online market and operations tests can be treated as attributable to the Mailing Online experiment. In particular, MASA/PII identifies the minimum payment of

¹¹³ *Id.* at 28.

¹¹⁴ Tr. 2/237-38.

\$251,867 to the Mailing Online market test printer as a market test cost that should be attributed to the Mailing Online experiment.¹¹⁵ In response to questions from the bench during the hearings on January 12, 2000, the Postal Service confirms that this cost was incurred without receiving printing services:

Witness Plunkett: "The \$251,867 represents payments that were made to satisfy the minimum payment of \$325,000 required in the contract."¹¹⁶

The OCA adds additional items from the market test to the minimum printer payment to obtain \$1.7 million in costs from the market test that are not included in the pre-experiment development and implementation costs presented by the Service.

The AP reports filed throughout the market test reported that total Mailing Online-specific costs were \$8,449,034. The OCA breaks out the market-test related expenditures from the total and finds that the Mailing Online-specific costs caused by the Mailing Online market test were \$19,029 of Mailing Online-specific advertising; \$5,490 of Mailing Online-specific help desk costs plus Mailing Online's share of shared help desk costs (i.e., 25% of total Shared help desk costs based upon witness Lim's workpaper C, or \$628,496); \$739,033 of hardware and software costs expended to develop version 2 of the Mailing Online system; \$64,400 of Mailing Online-specific communications costs; and \$251,867 of printer costs, guaranteed to the printer by the Postal Service (Tr. 2/142, 264-65). These costs sum to \$1,708,315. OCA Reply Brief at page 13, fn. 38.

The OCA cites \$19,486 in offset revenue, as reported in the final weekly report filed on December 7, 1999 in the market test. With the offset, the unrecovered Mailing Online market test costs are \$1,688,829.

The OCA concludes that "[I]f, as a factual matter, the Commission finds that the operations test and market test phases are part of the start-up of Mailing Online, then the Commission may consider it appropriate to add the operations test costs and the market test excess costs to the experimental start-up costs reported by witness

¹¹⁵ MASA/PII Brief at 39.

¹¹⁶ Tr. 2/274.

Poellnitz.”¹¹⁷ The OCA cites statements by witnesses Garvey, Seckar, Plunkett and Lim to argue that the market test and experiment are part of the development of the Mailing Online product and that it is an evolutionary process. The OCA goes on to cite Commission decisions in the E-COM case that ratepayers can be responsible for shortfalls in previous rate cycles.¹¹⁸

On reply the Service asserts that pre-experiment costs are excluded from the cost basis used for pricing Mailing Online for sound operational, economic and precedential reasons.¹¹⁹ Specifically, the Service asserts that any costs associated with the market or operations tests belong to a separate program distinct from the entirely redesigned Mailing Online that will be tested during the experiment. The market and operations tests are equivalent to research and development which the Commission traditionally does not treat as attributable to any particular subclass or special service and, consequently, these costs are not caused by any particular service.¹²⁰ The Service further states that 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. “Similarly, the Postal Service properly does not include in the experimental cost base those costs incurred for prior versions of Mailing Online.”¹²¹

The Commission agrees with OCA and MASA/PII that the operations test, market test, and experiment are all part of the development and implementation of the Mailing Online program.¹²² The Commission also recognizes the validity of Postal Service’s assertion that losses incurred in each separate phase can be viewed as research and development costs that are incurred as part of the development of the

¹¹⁷ OCA Reply Brief at 13.

¹¹⁸ *Id.* at 17-18.

¹¹⁹ USPS Reply Brief at 12.

¹²⁰ *Id.* at 14.

¹²¹ USPS Brief at 13.

eventual permanent service. Attempting to recover all previous losses in each phase of the development of a new product might unreasonably inflate the “experimental” price, and render the rates unrealistic. When, and if, the Mailing Online is offered as a permanent service, then all the unrecovered research and development costs from all phases, including the operations, market test and experiment phase, should be recovered through inclusion on an amortized basis in the markup for the permanent service. Consequently, the Commission does not treat the unrecovered costs from the operations and market test caused by Mailing Online as attributable for the experiment but requires the Service to carry those costs for repayment by any future permanent classification.

E. Mailing Online Market Test Advertising Costs

As part of the Commission decision for the Mailing Online market test, the Service was required to collect and report information on all advertising expenditures involving Mailing Online during the test period, including joint and common costs with PostOffice Online (POL). Those reports identify \$4.7 million in joint and common marketing costs and \$19,029 in Mailing Online product specific, as specific to Mailing Online.¹²³ The product specific costs are included in the \$1.7 million dollar unrecovered market test costs identified by the OCA from the activity reports and is to be carried forward, per the above discussion, to any future permanent Mailing Online request rather than treated as attributable for the experiment.

The Postal Service asserts that none of the joint and common advertising costs with PostOffice Online should be allocated to either Mailing Online.¹²⁴ The Service also

¹²² MASA/PII Brief at 31-34, OCA Brief at 9-14.

¹²³ Accounting Activity Reports for FY99 AP 11 and 12 present advertising costs specific to Mailing Online as distinct from other joint and common advertising costs identified in the reports.

¹²⁴ USPS Brief at 18.

argues that any market test expenditures are not attributable to the experiment since the market test and experiment are two distinct activities. On the other side, MASA/PII and the OCA argue that some portion of these joint and common costs should be treated as attributable to Mailing Online for the experiment, but do not make a specific proposal for what the portion should be or how it should be identified.

The intent of the Commission in requiring the market test reports was to permit the parties to develop a basis for the division of some of the joint and common costs to the involved services. Lacking any specific proposal, other than the Service's argument to attribute no joint and common costs, the Commission does not have a suitable record basis for attributing any portion of the \$4.7 million joint and common advertising costs to Mailing Online.

The Commission remains concerned about advertising costs being characterized as joint and common when some basis, such as percentage of participation in the advertisement, may be available as a distribution guide. Consequently, the Commission will continue to require the Service to capture all marketing costs which involve Mailing Online during the experiment, as well as descriptive information on the type of marketing that might provide a basis for allocating some of the costs among the services being marketed. Then, at least an opportunity may exist to consider possible allocations of joint and common advertising costs as part of a request for permanent Mailing Online classification that may occur in the future. To facilitate an examination of the joint and common advertising costs, the data collection plan includes a requirement for reports on all such efforts that involve Mailing Online.

F. Credit Card Fees

MASA/PII claims that \$13.8 million in bankcard service charges should be included in the attributable cost base for Mailing Online during the experiment. The number is 3 percent of total non-postage Mailing Online revenue presented by witness

Plunkett.¹²⁵ MASA/PII uses the 3 percent rate on the grounds that the Postal Service claims that payments will not exceed 3 percent as stated in response to MASA/PII/USPS-T1-17 (Tr. 2/140). OCA does not take a position on this issue.

The Postal Service responds by pointing out that 3 percent is a maximum, so the \$13.8 can not be used as the amount to attribute. The Postal Service also cites witness Garvey's understanding that costs of payment methods are not attributed to specific services.¹²⁶ However, procedures do exist within the Postal Service cost systems for allocating costs incurred in paying for postal products through window services.

The Service has made it clear that 3 percent is a maximum while agreeing that some bankcard fees will be incurred. Lacking a specific percentage, the Commission will adopt 1.5 percent as a reasonable proxy for the actual percentage and require that bankcard fee expenditure be included in the data collection plan for the experiment and be reported to the Commission. The 1.5 percent is applied only to the Mailing Online specific costs and is not applied to the postage for this mail. Procedures already exist in the cost systems for accruing expenses from bank fees incurred in the sale of stamps, determining variable portions and distributing costs to subclasses.

G. Help Desk

Postal Service witness Lim estimates the total costs for the help desk operations in support of all of the USPS.com services as \$14.1 million during the period the Mailing Online experiment will be in effect and then allocates 25 percent, or \$3.5 million to Mailing Online. The 25 percent rate is the percentage of calls for Mailing Online assistance during the market test when Mailing Online was offered as part of PostOffice Online.¹²⁷

¹²⁵ MASA/PII Brief at 38.

¹²⁶ USPS Reply Brief at 21, Tr. 2/140.

¹²⁷ USPS-T-2 at 9-10, Workpaper C.

MASA/PII asserts that using the number of calls as the cost driver underestimates the actual costs that will be caused by Mailing Online. MASA/PII points out that, based on activity reports from the Mailing Online market test, the number of inquiries per transaction was 4.5 for a service that had very little volume and was not heavily marketed for a substantial part of the market test period. MASA/PII states that the Commission should consider the per inquiry cost and calculate the imputed Help Desk cost in light of the projected transaction flow.¹²⁸

On reply, the Postal Service notes that witness Lim considered his calculation of help desk costs as conservative since the USPS.com help desk will support a larger number of services than existed for PostOffice Online during the market test. Also the market test Mailing Online programs had numerous problems, whereas the Mailing Online experiment has been delayed to obtain a system that works well. The Service notes that witness Lim provides the only help desk cost estimate in the record.¹²⁹

Not having an example of Version 3 of the Mailing Online software, it is difficult to predict if it will work better or worse than the Version 2 software used in the market test. Thus there is no basis for determining if the experience of 4.5 calls per transaction will occur again or if the need for help desk assistance will rise or drop. Given this situation, the Commission accepts the percentage of calls as a cost driver for Mailing Online's share of the USPS.com help desk costs during the experiment. The issue will be examined in any future permanent rate case involving Mailing Online and the Service should collect appropriate information during the experiment to determine the appropriate cost driver.

¹²⁸ MASA/PII Brief at 35-36.

¹²⁹ USPS Reply Brief at 20.

H. Revenue Leakage

MASA/PIL argue that up to \$41.3 million in revenue will be lost due to a transfer of First-Class to Standard A and from non-discount mailings to discounted mailings.¹³⁰ The Service counters on reply that such losses of revenue are not traditionally treated as attributable. The Commission agrees that potential revenue leakage caused by changes in classification are not considered costs, although they are relevant to evaluating the wisdom of a proposal. In the experiment, the potential leakage is outweighed by the expectation that new business is being generated and customers are receiving improved services. The Commission will not treat the asserted revenue leakage as a cost in this case.

I. Total Attributable Costs and Rounded per Impression Unit Costs

Table 2 identifies the costs that the Commission treats as attributable for the three years of the Mailing Online experiment. The total cost, excluding printer costs, is \$46.5 million. All cost and revenue analyses presented in this docket use Postal Service volume projections presented in MC98-1, LR-2, Table 15. As previously discussed, volume projections were developed by witness Rothschild for use in MC98-1 and are based on survey research by National Analysts, Inc. Survey participants were presented price and product options and asked to estimate likely usage. The responses are the basis of volume estimates given in LR-2. The price options used to develop the volume projections presented in Table 15 do not match exactly the prices being proposed by the Service, however the prices are reasonably similar. These volumes are used to develop the costs and revenues that the Postal Service witnesses present in USPS-T-2, T-3 and T-5, the only cost estimates developed on the record. No party has argued for the substitution of other volumes from the Rothschild analysis

¹³⁰ Tr. 4/899-902.

or presented a specific modification of these volumes. Furthermore, witness Rothschild does not develop demand elasticities that would allow adjustment of the volume projection as a result of price adjustments. Consequently, the Commission also uses these volume estimates in developing cost and revenue projections for the fees being recommended.

Witness Poelnitz uses the results of witness Rothschild from LR-2, Table 15, to develop an estimate of 10,961.7 million impressions over the three years of the experiment.¹³¹ Total non-printer costs during the experiment are \$46,479,247, as shown in Table 2. Thus the unit attributable non-printer costs are 0.424 cents per impression. This amount, added to the actual printing costs, will be the basis for calculating the contribution to institutional costs provided by Mailing Online. However, consistent with the Postal Service proposal, the unit cost to be included in the DMCS as a fee is rounded to the next highest tenth of a cent, 0.5 cents per impression. This is consistent with previous Commission decisions to set rates at tenths of a cent.

Table 2: Mailing Online Attributable Costs

<u>Cost Type</u>	<u>Costs In \$</u>	<u>Source</u>
Printer Costs	348,198,720	USPS-T-5, Exhibit D (Corrected)
Non-Printer Costs		
Volume Variable Information Technology (IT) Costs	4,811,765	USPS-T-5, Exhibit D (Corrected)
Product Specific IT Costs	30,303,918	USPS-T-5, Exhibit D (Corrected)
Advertising Cost Budget	2,175,000	USPS-T-5, Exhibit D (Corrected)
Credit Card Fees (Max. 1.5% of sales)	9,188,564	0.015 times revenue in Table 3
Subtotal (Non-Printer Costs)	<u>46,479,247</u>	
Total	<u>394,677,967</u>	

¹³¹ USPS-T-2, Exhibit A, Table 13; line 84.

VI. NON POSTAGE MAILING ONLINE PRICING

The Postal Service proposes a pricing approach for Mailing Online that includes three elements: printer charges, impression fee, and a markup. The markup is applied to both the printer's charges and the impression fee. The Postal Service proposes that Mailing Online customers be charged unit service fees for printing and handling equal to the amounts in the contracts between the printers and the Postal Service. The competitive contract process will determine the printer costs. The impression fee and markup are the focus of the ratemaking process in this docket.

A. Impression Fee

The Postal Service proposes a per impression fee of 0.1 cents.¹³² The OCA proposes an impression fee of 0.5 cents in order to recover the 0.34 cents it calculates as unit attributable costs and to allow for overestimation of volume by witness Rothschild.¹³³ MASA/PII does not propose a specific impression fee, but argues that the attributable base for markup should include all product specific costs.¹³⁴ Given that MASA/PII identifies more product specific costs than the OCA, the impression fee that MASA/PII might advocate would be at least as great as that argued for by OCA.

The Service argues that the 0.1 cent per impression fee is based on volume variable unit costs and, as a result of rounding, "will more than cover attributable costs" and will generate sufficient revenues to cover all incremental costs and make a substantial contribution.¹³⁵ As discussed above, the OCA argues that the incremental

¹³² This fee is designed to recover the unit volume variable information costs, which witness Poellnitz calculates as 0.0439 for the three-year experiment period. Response to POIR No 1, Question 2.

¹³³ OCA Brief at 13-14.

¹³⁴ MASA/PII Reply Brief at 8.

¹³⁵ USPS Brief at 21.

costs calculated by the Postal Service should be attributable and may include additional costs.

On reply brief the Postal Service argues against the OCA proposal on the grounds that the product specific costs included in incremental costs do not vary with volume, so they are not properly expressed on a per-unit basis. Moreover, rounding up generally should apply only to rates, rather than costs. As alternatives to rounding the unit cost to obtain the impression fee, the Service suggests either apply the markup to unit cost and then round up or do no rounding. Additionally, the Postal Service correctly points out that the OCA rounding up to 0.5 instead of 0.4 to account for possible overestimation by Rothschild is equivalent to reducing the Rothschild volume estimates by a specific amount without record evidence.¹³⁶

The Commission traditionally treats product specific costs as attributable and marks up all attributable costs to calculate coverage. Witness Takis' suggestion that product specific costs should be viewed as incremental, rather than as attributable, does not conform to the Commission policy of considering as attributable all costs caused by each service. Product specific costs are undeniably caused by that service. As discussed above, the Commission calculates the non-printing related unit attributable cost of Mailing Online as 0.424 cents per impression, which rounds up to 0.5 cents per impression. The Service's alternative proposal to not round up to a tenth of a cent would require recommending an impression fee expressed to the one hundredths of a cent. Since rates and fees are not smaller than one tenth of a cent, the Commission will round up and recommend a fee based on 0.5 cents per impression, but it will use the actual total costs in the calculation of coverage, thereby reducing the markup and eliminating any adverse impact from rounding on rate payers.

¹³⁶ USPS Reply Brief at 30-32.

B. Markup and True Cost Coverage

The Postal Service proposes to mark up both the printer and the impression fee charges to the customer by 30 percent. The Service identifies per impression unit costs of 0.0437 cents which it rounds up to arrive at the impression fee charge of 0.1 cents per impression. Therefore, the cost coverage from the Service's attributable costs is 132.3 percent. The Postal Service argues that the 30 percent markup, or 132.3 cost coverage, will have a positive effect on underserved postal customers and would not disadvantage competitive service providers. It is fair and equitable in comparison to other special services, many of which have cost coverages under the system average. Like other special services, Mailing Online will make significant indirect contribution to institutional costs by making First-Class and Standard A mail more convenient and foster volume growth.¹³⁸ Further the Service cites the decision in R97-1 recommending a 107 percent cost coverage for Delivery Confirmation for the proposition that a new service may provide system-wide benefits, yet have a relatively low cost coverage because the quality of the service is untested.¹³⁹

The Service cites the Commission's decision in MC98-1 that a markup below average is appropriate during the market test and argues that Mailing Online is still a price sensitive experimental service that needs reasonably low fees to attract its customers. The Service contends that if the attributable base is increased, with a resultant drop in cost coverage, then the lower cost coverage is appropriate.¹⁴⁰ As the Postal Service points out, if the costs it deems incremental costs are treated as attributable, then the cost coverage is only 121.1 percent.¹⁴¹ In contrast, the OCA

¹³⁷ *Id.* at 37.

¹³⁸ USPS Brief at 21-22.

¹³⁹ USPS Reply Brief at 34.

¹⁴⁰ *Id.* at 33.

¹⁴¹ *Id.* at 37.

computes 0.34 cent per piece attributable cost and recommends that be rounded to 0.5 for the impression fee to which a 30 percent markup should be applied.¹⁴² This recommendation equates to a coverage of 135.9 percent on the printer costs and impression fee charges.

MASA/PIL recommends that the markup be in the range of 50 percent in order "to protect against unfair competition with private industry in products and services outside the postal monopoly, and consistent with Commission precedent."¹⁴⁴ MASA/PIL cites the 55 percent markup the Commission adopted for packaging service and 47 percent for money orders as evidence of the appropriate level of markup for competitive services. It also notes that the Postal Service proposed a 154 percent cost coverage to guard against improper competition with respect to insurance against the loss or damage to articles of mail, and requested a 60 percent markup in the first Pack and Send case.¹⁴⁵

In MC98-1, the Commission agreed with the Postal Service on a 25 percent markup for the market test. At the time of the recommendation and opinion, the geographically limited market test was expected to last for a few months and, at most, one year. Such a short time frame limits the potential negative impact on competitors. However, this experiment involves a nationwide service that may last more than three years. As MASA/PIL points out this longer time period could negatively impact both existing businesses and future competitors. MASA/PIL also points out that the competing businesses that may be harmed by Mailing Online extend beyond any providers of functionally equivalent services, to print shops serving small markets. For

¹⁴² OCA Brief at 13, OCA Reply Brief at 8.

¹⁴³ OCA Reply Brief at 8.

¹⁴⁴ MASA/PIL Brief at 40.

¹⁴⁵ Tr. 4/895.

these reasons, MASA/PII recommends that the Commission consider a markup in the range of 50 percent, which equates to a coverage in the range of 150 percent.¹⁴⁶

The potential competition is not grounds for denying the Mailing Online experiment request, but it does increase the need to make certain that unfair advantages are not provided to the Service by a low cost coverage. One way to blunt accusations of bias in terms of the contribution to institutional costs is to use the system wide average coverage from the most recent rate case, R97-1, of 155 percent.¹⁴⁷ As shown in Table 3, a customer markup of 52.0 percent, on the printer costs and the 0.5 cents per impression fee, produces a coverage of 155.2 percent, which is equal to the system wide average rounded to a whole percent. The rounding of the actual unit costs from 0.424 cents to 0.5 cents per impression creates an additional contribution to revenue over costs of 0.076 cents per impression. This additional contribution is the reason that the customer markup of 52 percent equates to a 55 percent markup over actual costs for a coverage of 155 percent.

¹⁴⁶ MASA Brief at 40.

¹⁴⁷ Docket No. R97-1, Appendices to Opinion and Recommended Decision, Volume 2, Appendix G. at 32.

Table 3: Mailing Online Attributable Costs, Revenue and Cost Coverage

ATTRIBUTABLE COSTS

1	Printer Costs	USPS-T-5, Exhibit D (Corrected)	\$348,198,720
2	Variable IT Costs	USPS-T-5, Exhibit D (Corrected)	\$4,811,765
3	Product Specific IT Costs & Pre experiment	USPS-T-5, Exhibit D (Corrected)	\$30,303,918
4	Advertising Costs	USPS-T-5, Exhibit D (Corrected)	\$2,175,000
5	Credit Card costs as 1.5% of total revenue	1.5% * Line 17	\$9,188,564
6	Subtotal of Non Printer MOL costs	Sum of lines 2 to 5	\$46,479,247
7	Impressions	Source: Ex. USPS-2A, Table 2	10,961,695,139
8	Unit Non Printer MOL costs per impression	Line 6/Line 7	\$0.00424
9	Attributable printer and non printer costs	Line 1 + Line 6	\$394,677,967

REVENUE

10	Revenue from printer charges	Line 1	\$348,198,720
11	Fee per impression	Round up to tenth of a cent of line 8	\$0.005
12	Impressions	Source: Ex. USPS-2A, Table 2	10,961,695,139
13	Revenue from fee per impression	Line 11 * Line 12	54,808,476
14	Subtotal	Line 10 + Line 13	403,007,195
15	Markup	Recommended	52.0%
16	Revenue From Price Markup	Line 14 * Line 15	209,563,742
17	Total revenue	Line 14 + Line 16	612,570,938
18	Coverage	Line 17/Line 9	155.2%

C. Functional Equivalent Annual Fee

The Stipulation Agreement calls for an annual fee to be paid by all applicants for treatment as functionally equivalent to Mailing Online. No specific amount was specified. The registration fee set in R97-1 for most services is \$100.¹⁴⁸ For this

¹⁴⁸ See DMCS Schedule 1000, January 10, 1999.

reason, the Commission recommends that the Mailing Online permit fee for services functionally equivalent to Mailing Online should be set at \$100. The Commission may revisit this fee when determining rates and classifications for special services in the pending R2000-1 docket.

D. Charging for FastForward and Address Management Services

MASA/PII asserts that the Postal Service should be required to charge for FastForward and Address Management Services that are to be provided as part of Mailing Online. These are services sold to mailers to improve address hygiene and improve mail handling

The Postal Service includes payments for FastForward and Address Management Services in the product specific development and implementation costs.¹⁴⁹ Consequently, these costs are included in the attributable cost base, as calculated by the Commission.

¹⁴⁹ USPS-T-3, Workpaper A, Item 61 and 134.

VII. RATE AND CLASSIFICATION CRITERIA

A. Pricing Considerations

The recommendations within this Opinion satisfy criteria of § 3622(b) of the United States Code, which require that postal rates and fees be set in accordance with the following factors:

- (1) the establishment and maintenance of a fair and equitable schedule;
- (2) the value of the mail service to both the sender and the recipient, including but not limited to the collection, mode of transportation, and priority of delivery;
- (3) the requirement that each class of mail or type of mail service bear the direct and indirect postal costs attributable to that class or type plus that portion of all other costs of the Postal Service reasonably assignable to such class or type;
- (4) the effect of rate increases upon the general public, business mail users, and enterprises in the private sector of the economy engaged in the delivery of mail matter other than letters;
- (5) the available alternative means of sending and receiving letters and other mail matter at reasonable costs;
- (6) the degree of preparation of mail for delivery into the postal system performed by the mailer and its effect upon reducing costs to the Postal Service;
- (7) simplicity of structure for the entire schedule and simple, identifiable relationships between the rates or fees charged the various classes of mail for postal service;
- (8) the educational, cultural, scientific, and informational value to the recipient of mail matter; and
- (9) such other factors as the Commission deems appropriate.

Mailing Online provides a high value of mail service to both the sender and the recipient of the mail (§ 3622(b)(2)). Traditional mail requires the mailer to compose and generate a physical mailpiece, address, stuff, seal and stamp an envelope, and then transport the mailpiece to a proper postal receptacle. Prior to these actions, the mailer must obtain paper, envelopes, and stamps. If a mailer is sending multiple documents, some of these steps may have to be repeated multiple times. For larger mailings, some mailers may contract with a professional mail preparation service.

Mailing Online simplifies and expedites the tasks involved in creating and sending mail. The Mailing Online system is designed as a convenient method to enter mail into the mailstream.¹⁵¹ The sender will be able to rapidly communicate with a recipient of mail using a personal computer and an Internet connection. The Mailing Online customer composes a document on a personal computer, along with an address list, communicates over the Internet with the Postal Service web site for Mailing Online, and enters "send" on the computer to initiate transmission of mail. This can all be done without ever having to leave ones home or office. This appears to be more convenient and valuable to a mailer than sending a traditional First-Class letter or Standard A mailing. The Postal Service does the mail preparation work, checks the accuracy of the address, and enters the mail into the mailstream as close to its ultimate destination as the Mailing Online system will permit. This is the fastest and most reliable form of collection available.

A mailer can send a single typical two-page letter using Mailing Online for approximately 41 cents. Compared to the current 33 cent postage the targeted market would be likely to pay to send the same message First-Class Mail, the Mailing Online user is getting exceptional value for an additional 8 cents. The small customer will now have access to automation discount rates for both single piece letters and larger

¹⁵⁰ USPS-T-1 at 1, 6.

¹⁵¹ USPS-T-1 at 1, 6.

mailings. Moreover, there is no need for Mailing Online users to pay the current \$100 annual fee to qualify to use the discount rates. New access is extended to a modern, quality, mail printing and preparation network that low volume mailers previously might not have been able to afford. This could benefit small businesses on a limited budget in producing professional quality mail matter.¹⁵²

The Postal Service proposes an eventual network of 25 print sites. Adding print sites to the system will allow a Mailing Online customer to enter mail closer to its final destination. The customer's pre-hard copy mail is sent electronically to a printer site near the destination facility. This is faster than the traditional method of transporting First-Class mail, and certainly at far greater speed than ground shipment of Standard A mail. This feature should substantially reduce the delay associated with transporting mail over great distances. Mailing Online mailpieces once entered into the mailstream should be capable of delivery as fast as First-Class Mail or Standard Mail depending on the type of postage selected.

In sum, the collection and mode of transportation for Mailing Online will be superior to that of any other postal product, and the priority of delivery will be the same as the subclass for which postage is paid. Recipients will benefit from faster and more reliable communications. The other aspects of Mailing Online described above also add value to the service actually provided to users. These factors all strongly suggest a relatively high contribution to institutional costs.

Mailing Online bears the direct and indirect postal costs attributable to the service plus that portion of all other costs of the Postal Service reasonably assignable to it (§ 3622(b)(3)). This Opinion discusses in detail the attributable costs of Mailing Online. Costs have been attributed where causation is demonstrated and when sufficient costing data exists.

¹⁵² Mailing Online targets smaller customers including the small office/home office market. Currently, these customers produce small mailings at the single piece rate, or do not mail at all. Request at 4.

The cost projections for certain aspects of the Mailing Online experiment are questionable due to the fact that there is no relevant experience. As discussed previously, the volume projections available on this record are highly speculative. They were developed a number of years ago and the nature of the service that the Postal Service will be offering to the public has evolved. Volume estimates for any new, experimental service are subject to substantial error, and flaws in the analysis sponsored by witness Rothschild are not surprising. However, the speculative nature of these volume estimates has an unusually significant impact on cost projections in this case.

The information technology costs of Mailing Online are quite small, less than one-half cent per piece, largely as a result of the expectation that these costs will be spread over a large volume of pieces. If this volume fails to materialize, Mailing Online will not recover these costs.

The most significant Mailing Online cost is for printing, and in estimating printing expenses the assumption is made that the cost of each piece of Mailing Online will directly reflect out-of-pocket expenses incurred by the Postal Service. If the Postal Service attains a certain minimum Mailing Online volume, this assumption will be correct. However, during the market test the Postal Service entered into a contract for printing under which it guaranteed the printer a minimum level of revenues. Mailing Online failed to attract sufficient volume necessary to recover that expense. Thus in retrospect, other mailers had to bear this burden. If Mailing Online fails to attract sufficient volume during this experiment to justify the minimum usage feature in the printer contracts, users of other classes of mail will have to bear these expenses.

When setting rates for established classes of mail, § 3622(b)(3) is generally satisfied through the accurate reflection of attributable costs. In this case unit costs are far more subject to error than is normal, because of the speculative nature of the volume estimates. OCA contends that volume estimates may well be too high. OCA

Brief at 15. If they are, unit cost estimates are too low. The uncertainty of volume and cost estimates makes it appropriate to attach a high markup to Mailing Online, thereby reducing the likelihood that this service will fail to meet the requirement that it recover attributable costs.

Mailing Online adds an alternative method to the available means of sending mail at a reasonable cost (§ 3622(b)(5)). The electronic generation and entry of mail utilizing the Internet is an alternative to the typical methods now used to generate and enter mail. The Postal Service contends that Mailing Online provides electronic access to the mailstream, and automation basic postage rates to a class of mailers who otherwise cannot obtain these benefits. It suggests these are indications that may justify a lower markup.¹⁵³

The available alternative means of sending and receiving letters and other mail matter at reasonable costs also relates to the impact that Mailing Online will have on competing services (§ 3622(b)(5)). As previously discussed and analyzed, Mailing Online will have some indirect impact on the mail preparation industry. The MASA/PII brief discusses increasing the markup proposed by the Postal Service to reduce the impact that Mailing Online has on the competition.¹⁵⁴ Many of the services provided by contract to Mailing Online reflect low costs relative to the competition due to the high volume that this service is predicted to generate. As noted above, the volume estimates available in this case are somewhat speculative, and a high markup will protect competitors from unfair, below-cost competition.

The concerns of the potential Mailing Online competitors must be balanced against the benefits to potential users. A low markup will encourage SOHO mailers without access to automation discount rates to use Mailing Online. All mailers will benefit if new markets can be fostered and if well-addressed, automation compatible

¹⁵³ *Id.* at 6; USPS Brief at 1.

¹⁵⁴ MASA/PII Brief at 40.

pieces are added to the mailstream. The Commission encourages the Postal Service to develop innovative way to make the use of the mail easier and more attractive. Markups for such experiments should be low enough to allow new services to be successful.

The Commission has determined that balancing these considerations justifies initially setting the markup at the system-wide average. The systemwide average is a neutral starting place in the analysis of the statutory factors affecting markups. An above average markup represents a higher than average burden making the subclass less affordable and less competitive. A below average markup makes the subclass more affordable and more competitive. As the experiment progresses, an indication of the impact on competition may be quantified justifying a higher or lower markup for a permanent Mailing Online service.

The degree of preparation of mail for delivery into the postal system provided by Mailing Online will have a positive effect upon reducing costs to the Postal Service (§ 3622(b)(6)). The Mailing Online customer has requirements for interacting with Mailing Online distinct from, but aiding in the efficient preparation of mail. Mailing Online mail pieces enter the mailstream as automation compatible "clean" mail pieces. Address correction is provided, including the future planned implementation of FastForward.¹⁵⁵ A high degree of presort, down to walk sequence, is proposed beyond the automation basic requirements.¹⁵⁶ The mail pieces will be entered in uniform standardized envelope sizes compatible with automation equipment. The high degree of Mailing Online mail preparation is somewhat reflected in the automation basic rates provided with the service. The high degree of preparation provided by Mailing Online suggests a moderate cost coverage.

¹⁵⁵ USPS-T-1 at 2, 15; USPS Brief at 2.

¹⁵⁶ USPS Brief at 18.

The non-postage portion of Mailing Online contains a complex rate structure with intricate relationships between rates and fees (§ 3622(b)(7)). Each printer could have a different fee schedule for the services offered by Mailing Online. An individual mailer sending identical mailings, except for the location of the recipients, could be charged different non-postage rates. The complexity involved typically would be of concern and argue for a lower markup. However, the rate structure is transparent to the customer. The Postal Service computers calculate costs for each individual job. The customer does not see the individual pricing elements involved.¹⁵⁷ The rate schedule that the public sees provides a single number for the markup over printer costs and attributable information technology fees. This rate schedule approach has the added benefit of not requiring a change to the rate schedule whenever a printer is added or printer costs change. The postage portion of Mailing Online uses the existing rate schedule.¹⁵⁸ In sum, the complexity of the rate structure does not require a below average markup.

Overall, the Commission finds that the rates it recommends are fair and equitable (§ 3622(b)(1)). The factors examined in § 3622(b) reflect a premium service, and generally support setting the associated cost coverage at the higher end of the possible spectrum. Countering this argument, the Commission recognizes Mailing Online as a new experimental service, justifying a lower rate. A lower rate may allow a new service time to start generating sufficient volume and become established. A lower rate could also be justified because this service is used in conjunction with and as a supplement to other Postal Service products, paying postage that also generates contribution to institutional costs. Balancing the above considerations, the Commission recommends applying the system-wide average to Mailing Online.

¹⁵⁷ The Commission recommends that the Service make the customer aware that non-postage prices will vary dependent upon where the mail pieces are printed. This will help to eliminate any customer confusion.

¹⁵⁸ The Commission recognizes the exception to the automation basic minimum volume requirement.

B. Mail Classification

The recommendations within this Opinion satisfy criteria of § 3623(b) of the United States Code, which require that classifications be set in accordance with the following factors:

- (1) the establishment and maintenance of a fair and equitable classification system for all mail;
- (2) the relative value to the people of the kinds of mail matter entered into the postal system and the desirability and justification for special classifications and services of mail;
- (3) the importance of providing classifications with extremely high degrees of reliability and speed of delivery;
- (4) the importance of providing classifications which do not require an extremely high degree of reliability and speed of delivery;
- (5) the desirability of special classifications from the point of view of both the user and of the Postal Service; and
- (6) such other factors as the Commission deems appropriate.

Mailing Online is consistent with the requirement to provide classifications with extremely high degrees of reliability and speed of delivery (§ 3623(c)(3)). Mailing Online mail pieces are automation compatible, sorted to the highest degree possible, and entered close to the point of destination. Address hygiene is preformed, eventually including FastForward. Subject to the contents of the mail matter, Mailing Online also provides a classification that does not require an extremely high degree of reliability and speed of delivery (§ 3623(c)(4)). Mail pieces may be entered at Standard Mail (A) rates where saving on postage expense takes priority over rapid delivery.

This service is desirable from the point of view of both the user and of the Postal Service (§ 3623(c)(5)). For the user, Mailing Online provides a convenient and

inexpensive method of generating and entering mail into the mailstream. The user receives the added benefit of the "worksharing" that Mailing Online provides through the automation basic postage rates. The Postal Service will also benefit from the added mail volume that Mailing Online generates. The mail is "clean" automation compatible mail mostly entered at the profitable automation basic rates. In conclusion, Mailing Online is beneficial to both the user of the mail and the Postal Service, and adds to the establishment and maintenance of a fair and equitable classification system for all mail (§ 3623(c)(1)). The Commission recommends the implementation of Mailing Online.

VIII. EXPERIMENTAL DATA COLLECTION PLAN

Commission Rule 67c, Part (b) requires a data collection plan to be part of the initial filing for an experiment. The Postal Service has complied with this rule by submitting the experimental data collection plan attached to witness Garvey's testimony.¹⁵⁹ In general the OCA and MASA/PII endorse the plan with proposals for clarification on some data elements, expansion of plans for reporting on joint marketing activities with other products, and more frequent reporting once a permanent request for a Mailing Online service is submitted.¹⁶⁰ MASA/PII also requests that information be collected about customers.¹⁶¹

A. Postal Service Proposal

The Postal Service proposes to continue to collect most data reported during the market test and to focus on three areas: use, operations and costs. The categories of data to be collected include revenues, costs and volumes by printing category and class of mail.¹⁶² Information that appears on postage statements will be available for analysis to determine the size of each mailing and the depth of sort achieved.¹⁶³

The Service claims that the Version 3 Mailing Online software is being designed to collect most of the data required for reports without the manual intervention required in the market test.¹⁶⁴ Also, "[i]nformation reported about the jobs that flow through

¹⁵⁹ See USPS-T-1, Appendix A.

¹⁶⁰ OCA Reply Brief at 4-5.

¹⁶¹ MASA/PII Reply Brief at 9.

¹⁶² Tr. 2/154-56.

¹⁶³ Tr. 2/101, Tr. 2/215-19.

¹⁶⁴ Tr. 2/252-53.

Mailing Online will be in electronic form, so that any interested analyst can cut the data as she sees fit.”¹⁶⁵

Unlike in the market test when reports were submitted as frequently as by accounting period, the Service proposes to submit semiannual reports during the experiment. This will allow Service to eliminate 44 separate reports.¹⁶⁶

B. OCA Proposal

The OCA on Brief makes several proposals for modification of the Service's data collection plan:

(1) Provide the total transactions by day as in the market test.¹⁶⁷ On Reply Brief, the Service states that information will be available in electronic form about jobs that flow through Mailing Online.¹⁶⁸ If data to be provided in electronic form does include records for each individual job, then the OCA request will be satisfied.

(2) Provide daily counts of users, pages, and volume by finishing characteristics, and volume per batch.¹⁶⁹ The Service proposes to provide data in electronic form on jobs that flow through Mailing Online and batches that constitute mailings submitted by Mailing Online into the mail stream. The data can then be sorted and reported by various finishing characteristics and time periods.

¹⁶⁵ USPS Reply Brief at 38, Tr. 3/467.

¹⁶⁶ USPS Reply Brief at 26.

¹⁶⁷ OCA Brief at 23.

¹⁶⁸ USPS Reply Brief at 38.

¹⁶⁹ OCA Brief at 24.

(3) On a weekly basis provide revenue and volume data by subclass and shape.¹⁷⁰ As in the first two requests, the data to be provided by the Service in electronic form will permit the weekly tabulation.

(4) Provide data in electronic form to facilitate analyses.¹⁷¹ On reply the Service reiterates its intention to provide the data in electronic form as a result of capabilities designed into Version 3 of the Mailing Online software to be used in the experiment.¹⁷²

(5) Collect and report all advertising, marketing and promotional costs that help promote the usage of Mailing Online.¹⁷³ The Postal Service does plan to report all the advertising costs incurred as part of the Mailing Online product specific budget. The concern however, is not with the product specific expenditures, but with any joint and common expenses such as those during the market test with PostOffice Online. OCA requests that joint and common advertising costs be reported. The USPS plans as amplified on reply do not appear to cover joint and common expenditures.¹⁷⁴

(6) Provide reports semiannually, but upon filing a request for permanent Mailing Online service, submit accounting period reports covering the time since the last semiannual report, and submit reports by accounting period thereafter.¹⁷⁵ The OCA considers this data necessary for consideration of the request without the delays caused by discovery.¹⁷⁶

¹⁷⁰ *Id.*

¹⁷¹ OCA Brief at 26.

¹⁷² USPS Reply Brief at 38.

¹⁷³ OCA Brief at 28.

¹⁷⁴ USPS Reply Brief at 38-40.

¹⁷⁵ OCA Brief at 28-29.

¹⁷⁶ OCA Reply Brief at 4.

OCA contends that there are not significant differences between its recommendations and the Postal Service's position.¹⁷⁷

C. MASA/PII Data Collection Proposal

On brief and reply, MASA/PII makes proposals similar to the OCA. For instance, on the collection of joint advertising costs, MASA/PII recommends collecting cost data on marketing costs for "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."¹⁷⁸ The Service disagrees. It claims that since there is a separate advertising budget that the Commission can safely require the reporting of just Mailing Online specific advertising expenditures.¹⁷⁹

MASA/PII expands on the OCA proposals by proposing that the "Service be required to collect information about customers concerning the source of MOL business so that competitive impact of MOL can be evaluated."¹⁸⁰ Such proposals were made for the market test, but rejected by the Commission on the grounds that it would be intrusive.¹⁸¹ MASA suggests that semiannual reporting is acceptable until a permanent request for a Mailing Online classification is filed, after which monthly reports should be required in order to have current data available.

D. Commission Analysis and Recommendation

The Commission essentially endorses the plan of the Service to continue to collect and report the data provided during the market test and to provide data in

¹⁷⁷ *Id.*

¹⁷⁸ MASA/PII Reply Brief at 8.

¹⁷⁹ USPS Reply Brief at 39.

¹⁸⁰ MASA/PII Reply Brief at 9.

¹⁸¹ Docket No. MC98-1, Opinion at 47.

electronic form on the flow of jobs through Mailing Online. However some of the clarifications recommended by the OCA and MASA/PII are warranted. Also the recommendations for having current performance data during the consideration of a request to implement a new permanent classification are useful. The expansion of the collection of data on joint and common advertising costs is warranted.

Regarding the OCA request for data on transactions, this should be available if a record is provided for each job submitted to Mailing Online. Therefore, it is essential for the Service to provide in electronic form information on individual jobs submitted to Mailing Online and on each mailing generated through the batching process and submitted by Mailing Online contract printers to the Service for entry into the mail stream.

The Service proposes to report data on the number of customers. This number may equal the number of transactions if each job is treated as a distinct customer, or may be less than the number of transactions if repeat customers are only counted once. Since it will be useful to know the number of distinct customers, and have data on the frequency of repeat usage, the Service is requested to provide information on the number of transactions, which will equal the number of customers including repeats, and the number of customers excluding repeats.

The Service makes a good point that providing data on individual jobs submitted to Mailing Online, and mailings entered by Mailing Online to the hardcopy mail stream, will allow analysts to analyze the data in numerous ways. However, in reviewing the semiannual reports to be submitted to the Commission, all parties should be able to have some measures readily available without further analyses by which a determination can be quickly made regarding the level of activity of Mailing Online. For example, summary data should be available on the number of transactions and piece volume for each semiannual reporting period, and on the distribution of jobs and volume by day, week or accounting period. These statistics could be in the form a

frequency table by decile with mean and medians for the total. This data would make the reports immediately usable by the Commission and other interested parties. Therefore, the Service is requested to provide statistics on performance as indicated in the summary of requirements at the end of this section.

The Commission agrees with the OCA and MASA/PII on the importance of knowing the cost of joint and common marketing efforts involving Mailing Online. The Service has indicated a willingness to "collect and report *any* costs associated with preparing advertising or promotional materials *associated* with Mailing Online during the experimental data collection plan."¹⁸² It is not necessary to presume that all marketing of USPS.com would identify Mailing Online, so it is not necessary to require in advance that all USPS.com advertising costs be reported. However, when Mailing Online is specifically promoted in a joint advertisement, the costs and extent of association should be reported. Such information could help parties evaluate whether a portion of the costs should be attributed to Mailing Online.

The Postal Service proffers two reasons for rejecting the MASA/PII and OCA proposals for more frequent reporting when a permanent request for Mailing Online service is filed: (1) The Postal Service has to justify a permanent request based upon information then available. As such, the request would have to stand on its own. (2) The OCA is already conducting discovery for data needs in anticipation of what may be needed in subsequent case.

The Commission recommends providing one report every six months for all periods prior to a request for a permanent Mailing Online. During this period, six to eight weeks to collect data and prepare each report is acceptable. Once a request is filed, the frequency of reporting shall be increased to every accounting period, with the data collected, prepared, and submitted to the Commission prior to the end of the following accounting period. Recognizing that there may be a gap between the last six

¹⁸² USPS Brief at 25, emphasis added.

month report filed and the first of the monthly reports filed, the Postal Service shall file reports covering any interim accounting period allowing six weeks to collect data and prepare the report. This does not require the Postal Service to collect any additional data, but it does place a burden on the Service to produce additional reports. Data gathered during the later portion of the experiment should provide greater insight into the success of Mailing Online. This information is valuable in analyzing a permanent version of Mailing Online and increasing the reporting frequency is the most straightforward method of assuring current data on which to base a decision.

The MASA/PII proposal for collection of information on the source of customers was rejected in MC98-1 as being intrusive. For the same reasons, the proposal is not adopted here.

E. Summary Data Collection Requirements

Data the Service proposes to collect and report semiannually are listed in Appendix A and repeated below. The Postal Service anticipates that collection of the data and preparation of each report will take between six to eight weeks, with cost data taking the longest since contractor billing cycles may not coincide with Postal Service reporting cycles. Additions and clarifications the Commission adds to the Service's proposed items are in italics.

- *Transaction (customers, with repeats counted separately)*
- *Distinct customers (excluding repeats)*
- Revenue
- Total page volume
- Total piece volume
- Volume by subclass
- Volume by shape
- Volume by page size
- Volume by envelope type
- Simplex pages

- Duplex pages
- Color pages

Operational data

- Volumes per batch by mail class
- *Sufficient data to recreate mailing statements, including data on depth of sort*

Customer Satisfaction:

- Postal Service will attempt to measure the need for additional features, customers' satisfaction, and the effect that price and other service attributes have on volume

Costs will be collected for the following functional areas of Mailing Online:

- Hardware
- Software
- Telecommunications & Networking
- Personnel
- Services
- Marketing (Both Mailing Online product specific costs and, when joint and common costs are incurred with other products, the total joint and common cost with some measure of the extent to which Mailing Online is involved, such as portion of an add or brochure describing Mailing Online.)
- System Development and Implementation
- Administrative Management and Maintenance
- Help Desk
- Mailing Online Print Sites (Information Technology costs)

Reporting

- Print site batch volume log, with dates of mailing
- Depth of sort information, from mailing statements
- Information Systems support personnel logs
- Customer Help Desk inquiries
- *For the usage and operational data listed above:*

- ◆ *Data bases in electronic form with a unique record for each transaction/job submitted to Mailing Online and for each batch mailing submitted by Mailing Online printer for entry in the mail stream.*
- ◆ *Total for the period.*
- ◆ *Summary statistics, such as mean value and decile frequency tables for the usage and operational data on a per day basis*
- *Report semiannually up to the submission of a request for permanent service classification.*
 - ◆ *With a request for permanent service, include data by Accounting Period between the last semiannual report and the submission of the request as available.*
 - ◆ *While the request is being considered by the Commission, submit reports by accounting period as available*

UNITED STATES OF AMERICA
POSTAL RATE COMMISSION
WASHINGTON, DC 20268-0001

Before Commissioners:

Edward J. Gleiman, Chairman;
George A. Omas, Vice Chairman;
Dana B. Covington, Sr.; Ruth Y. Goldway;
and W.H. "Trey" LeBlanc III

Mailing Online Experiment

Docket No. MC2000-2

RECOMMENDED DECISION

(Issued June 21, 2000)

A public hearing having been held in the above-entitled proceeding, and the Commission, upon consideration of the record, having issued its Opinion on the Postal Service Request for an experiment in this docket, which is attached hereto and made a part thereof,

IT IS ORDERED:

That the Commission's Opinion be transmitted to the Governors of the Postal Service and that the Governors thereby be advised that:


1. The fees set forth in Appendix One hereof are in accordance with the policies of title 39 of the United States Code and the factors set forth in § 3622(b) thereof; and they are hereby recommended to the Governors for approval.

Docket No. MC2000-2

2. The amendments to the Domestic Mail Classification Schedule set forth in Appendix Two are in accordance with the policies of title 39 of the United States Code and the factors set forth in § 3623(c) thereof; and they are hereby recommended to the Governors for approval.

By the Commission.

(S E A L)


Margaret P. Crenshaw
Secretary

SEPARATE OPINION IN CONCURRENCE WITH THE POSTAL RATE
COMMISSIONERS' RECOMMENDATION TO APPROVE THE MAILING ONLINE
EXPERIMENT IN DOCKET NO. MC 2000-2 AND DISSENTING FROM THE
MAJORITY'S RATE RECOMMENDATION

STATEMENT OF COMMISSIONER GOLDWAY

I regret that I must dissent from the rate recommendation and proposed fee schedule of the Commission majority. I fully support their decision to recommend that the Postal Service proceed with the Mailing Online Experiment and I am gratified that, as a result of the Commission's diligent review process, the Postal Service has stipulated to make the basic automation postage rate available to all those services that are functionally equivalent to MOL. However, I believe the PRC's fundamental statutory responsibilities include a rate review and recommendation process which identifies the lowest possible postal rates consistent with the ongoing efficiency of the Postal Service and that ensure fair and universal service.

The majority decision recommends the imposition of the system-wide average markup which is more than 73% greater than that requested by the USPS *and* recommends that markup be multiplied on a per impression cost basis that is five times greater than the Postal Service proposes.¹ I believe any decision to recommend markups, cost attributions and rates that are higher than those requested by the Postal Service must be made with great caution. Such a decision must be based on the clearest findings of Postal Service necessity, e.g., such rates are needed to cover costs or meet the revenue breakeven requirement – or clear findings that the rates as proposed would harm Postal Service competitors to such an extent that competition and ultimately consumers would be harmed. The Commission decision does not meet this test.

¹ The majority opinion (hereinafter, "Opinion") adds that the difference between its attributable cost and markup analysis and the Postal Service proposal result in a typical 2-page First-Class piece costing 40.9 cents versus 37.9 cents (including 27 cents for postage). Opinion at i. The resulting 7.9% increase is not a small price difference, and the difference is magnified for larger pieces. For example, an 8-page spot color mailing would increase by 11.7 cents or 18.1%.

The majority decision does not dispute that the USPS requested markup would cover costs.² However its several decisions with regard to specific cost attributions plus its imposition of a high markup send the wrong signal to the Postal Service concerning any attempts it may make to innovate. It also sends the wrong signal to the private sector, which, if this opinion holds, will motivate them to appear before us in attempts to elevate Postal Service prices on competitive services as a way to dampen competition generally. As the Supreme Court has stated,³

cutting prices in order to increase business is the very essence of competition. Thus, mistaken inferences in cases such as this are especially costly, because they chill the very conduct the antitrust laws are designed to protect.

The majority claims to espouse application of general antitrust principles and correctly recites that antitrust is designed to foster fair competition, not to protect individual competitors.⁴ I find that it has misapplied or misunderstood those principles, protecting a small group of competitors at the expense of the overall public, e.g., recommending a higher-than-requested markup.⁵ Rather, in recognition of the value this service could provide to the general public, the Commission would be well served by following its own decision in the earlier Mailing Online Service, Docket No. MC98-1 and, at a minimum, adopting a lower markup.

² See generally Opinion at 59 *et seq.*

³ *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 594 (1986).

⁴ See generally Opinion at 33.

⁵ See, e.g., these statements: "Many of the services provided by contract to Mailing Online reflect low costs relative to the competition due to the high volume that this service is predicted to generate. As noted above, the volume estimates available in this case are somewhat speculative, and a high markup will protect competitors from unfair, below-cost competition." Opinion at 72. "The potential competition is not grounds for denying the Mailing Online experiment request, but it does increase the need to make certain that unfair advantages are not provided to the Service by a low cost coverage. One way to blunt accusations of bias in terms of the contribution to institutional costs is to use the system wide average coverage from the most recent rate case, R97-1, of 155 percent." Opinion at 65.

The Statutory Issue

An important reason for my decision to issue a dissent with regard to rates lies in the D.C. Circuit's statement about §3622(b)(5), one of the ratemaking criteria we must follow:⁶

As to §3622(b)(5), the Commission has consistently, and reasonably, held that it authorizes a reduction in rates to maintain the position of the Postal Service as a competitor in the mail delivery industry.

MOL is but one attempt by the Postal Service to innovate in order to survive into the next century, financially able to meet its universal service obligation. In order to fend off the ultimate challenges from electronic diversion, it must create new business opportunities. We may be skeptical of its capacity to succeed in new areas but, in fact, the Postal Service is obliged to do this by the postal laws. The postal policy of the United States, at 39 U.S.C. §101, however Byzantine it may seem at times, has one steadfast beacon, set forth at 39 U.S.C. §101(e):

In determining all policies for postal services, the Postal Service shall give the highest consideration to the requirement for the most expeditious collection, transportation, and delivery of important letter mail.

The Postal Service is attempting to meet this policy on two levels here. First, on the micro level, it has designed a service targeted to a small business market, one that is growing rapidly in today's economy. Second, if this venture is successful, the Postal Service will enjoy two economic benefits, one from the MOL service and one from an increased usage of the mailstream. Eventually, if the service proves a success, the Postal Service will reap financial rewards that can be passed on to the general rate-paying public.

In reaching the relatively high rate levels that accrue from its cost attribution and markup process, the majority must take into account 39 U.S.C. §3622(b)(4), which states that we must consider "the effect of rate increases upon the general public,

⁶ United Parcel Service, Inc. v. U.S. Postal Service, 184 F.3d 827, 845 (D.C. Cir. 1999).

business mail users, and enterprises in the private sector of the economy engaged in the delivery of mail matter other than letters.”⁷ We have wide discretion in applying the §3622(b) ratemaking factors,⁸ but there are problems with applying §3622(b)(4) in the context of experimental cases, and this case in particular.

First, the statute speaks to “the effect of rate increases upon the general public.” Here, though, we have not a rate increase but a brand new rate. Another problem with the statutory wording, which speaks only in terms of rate increases, is that consideration is to be given to some (but not all, as discussed below) Postal Service competitors. But Postal Service competitors, generally speaking, *like* rate increases (so competition against them is lessened). Perhaps one can argue that for the statute to make any sense, it should not apply in experimental cases or even permanent rate and classification cases when the Postal Service is proposing a wholly new service. After all, the competitive effects evidence, based as it on such necessary gossamer as projected volumes, is not often going to prove reliable.

The more serious statutory interpretation problem for the majority is that they seek to make *de facto* use of §3622(b)(4) to protect firms (such as MASA members) involved in the letter mail business. Perhaps the closest the majority comes to admitting reliance on §3622(b)(4) is its statement that “the Commission statutorily is required to also consider both the benefits of competition and the *impact Postal Service products may have on enterprises in the private economy.*”⁹ The MOL proposal involves letter rates.¹⁰ The clear wording of §3622(b)(4), “other than letters,” is that the Postal Service letter monopoly should be protected. Note that the majority opinion

⁷ As we shall see, however, the majority avoids this statutory provision and concentrates on arguments concerning other rate setting criteria. The majority cannot escape the fact that its decision reflects the price competition arguments made by MASA, which directly implicate §3622(b)(4).

⁸ United Parcel Service, Inc. v. U.S. Postal Service, 184 F.3d at 845.

⁹ Opinion at 25-26 (emphasis added).

¹⁰ Opinion at 2-3.

studiously avoids direct mention of this criterion because its clear directive conflicts with the majority's findings that "unfair competition" must be prevented.¹¹

Even if the above statutory infirmities could be overcome, I do not think the proper interpretation of §3622(b)(4) is to protect competitors at all costs. The Commission decision in the market test portion of the case states that a national policy favoring competition is reflected in the Postal Reorganization Act.¹² Here, that principle is weakened: "Whereas antitrust laws are meant only to protect competition and not the individual competitors, the Commission statutorily is required to also consider both the benefits of competition *and the impact Postal Service products may have on enterprises in the private economy.*"¹³ The majority attempts to reconcile these allegedly contradictory phrases in its discussion at pages 25-26 of the Opinion, which need not be repeated here. The problem with the majority's ultimate position is that if one protects competitors without regard to the probable effects on competition and the consumer, one likely will end up with higher prices and the protection of inefficient operations. We are all sympathetic to struggling businesses, but the American economy and its citizens have prospered precisely because we recognize that in a market economy there are winners and losers.

Rather than avoiding mention of §3622(b)(4), I submit that one can and should interpret §3622(b)(4) to be consistent with the antitrust laws. After all, §3622(b)(4) tells us *to look at the effect on the general public and business mail users as well as competitors*, which should mean, among other things, that we act to ensure that the general public and business mail users generally will benefit from low (but above cost) Postal Service prices. As I discuss later below, our concern should focus on harm to competitors *if* it results in harm to competition and ultimately harm to consumers.

¹¹ See, e.g., Opinion at 65, 72.

¹² Mailing Online Service, Docket No. MC98-1, at 21.

¹³ Opinion at 25-26 (emphasis added).

Even if one concedes that MASA has standing to seek the Commission's price protection, other factors in the statute, which we are obligated to consider, point to a lower markup:¹⁴

By its terms, §3622(b)(4) allows the Commission to consider lowering rates in order to protect 'the general public [and] business mail users As to §3622(b)(5), the Commission has consistently, and reasonably, held that it authorizes a reduction in rates *to maintain the position of the Postal Service as a competitor in the mail delivery industry.* [emphasis added]

The National Policy Favoring Competition

The majority opinion states that the "Commission does not enforce the anti-trust laws—though anti-trust policies, principles, and concepts are often used as a framework for analyzing the competitive nature of a proposed service in setting rates and classifications."¹⁵ I think that §3622(b)(4) should therefore be interpreted so that competitors should be protected to the extent not doing so will harm the competitive process and ultimately consumers. I believe the Commission has misapplied basic competitive principles of our nation's economic policy, which is to protect competition, not competitors, in order to give consumers lower prices and a better selection of products. Generations of Supreme Court majorities, composed of liberals and conservatives alike, have espoused the same basic philosophy about the positive results of competition. So, for example, Justice Black said in a 1958 decision:¹⁶

The Sherman Act was designed to be a comprehensive charter of economic liberty aimed at preserving free and unfettered competition as the rule of trade. It rests on the premise that the unrestrained interaction of competitive forces will yield the best allocation of our economic resources, the lowest prices, the highest quality and the greatest material progress, while at the same time providing an environment conducive to the preservation of our democratic political and social institutions. But

¹⁴ United Parcel Service, Inc. v. U.S. Postal Service, 184 F.3d at 845, and cases cited therein.

¹⁵ Opinion at 25-26.

¹⁶ Northern Pac. Railway v. U.S., 356 U.S. 1, 4 (1958).

even were that premise open to question, the policy unequivocally laid down by the Act is competition.

When interpreting (b)(4) and considering raising a proposed rate, we need to pay particular heed to the Supreme Court's admonition that:

[W]e have rejected elsewhere the notion that above cost prices that are below general market levels or the costs of a firm's competitors inflict injury to competition cognizable under the antitrust laws.¹⁷

* * *

To hold that the antitrust laws protect competitors from the loss of profits due to such price competition would, in effect, render illegal any decision by a firm to cut prices in order to increase market share. The antitrust laws require no such perverse result.¹⁸

I wish that the majority had relied more on the reasoning used in the precursor to this proceeding, the unanimous decision in Docket No. MC98-1, where, in analyzing intervenors' rate discrimination argument, the Commission stated that abstract assertions of rate discrimination were not dispositive, citing with approval *Brooke Group*, 509 U.S. at 220.¹⁹ The opinion there correctly observed that under accepted competitive analysis: "That below cost pricing may impose painful losses on its target is of no moment to the antitrust laws if competition is not injured: It is axiomatic that the antitrust laws were passed for the 'protection of competition, not competitors.'"²⁰ Note that during the market test proposal being examined in Docket No. MC98-1, the Commission approved a 125% cost coverage, even lower than that requested by the Postal Service here.

¹⁷ *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 223 (1993).

¹⁸ *Ibid.*

¹⁹ Docket No. MC98-1, Opinion at 23.

²⁰ *Id.* at 23, n.13, citing *Brooke Group*.

Using the Systemwide Cost Coverage Average as A Default

The majority decision adopts the same basic position it did in *Provisional Packaging Service*, Docket No. MC97-5, employing an arbitrary systemwide markup in response to assertions by an incumbent group of firms that its members cannot compete with the Postal Service. It reasons, in part:²¹

However, this experiment involves a nationwide service that may last more than three years. As MASA/Pll points out this longer time period could negatively impact both existing businesses and future competitors. MASA/Pll also points out that the competing businesses that may be harmed by Mailing Online extend beyond any providers of functionally equivalent services, to print shops serving small markets. For these reasons, MASA/Pll recommends that the Commission consider a markup in the range of 50%, which equates to a coverage in the range of 150.

The potential competition is not grounds for denying the Mailing Online experiment request, but it does increase the need to make certain that unfair advantages are not provided to the Service by a low cost coverage. One way to blunt accusations of bias in terms of the contribution to institutional costs is to use the system wide average coverage from the most recent rate case, R97-1, of 155 percent.

There is no sound economic theory or legal principle for using the average as a starting point or a default. The Act presumes that one can consider the situation, including all of the factors, and reach a decision on the most appropriate markup. To default to the average when it will raise the rate level above not only cost but what is requested seems to me especially problematic.

Curiously, the majority also reasoned:²²

Many of the services provided by contract to Mailing Online reflect low costs relative to the competition due to the high volume that this service is predicted to generate. As noted above, the volume estimates available in

²¹ Opinion at 64-65. *Compare* Docket No. MC97-5, Opinion at 49: "An average cost coverage will provide a more level competitive playing field for the Postal Service and firms in private industry providing packaging services."

²² Opinion at 72.

this case are somewhat speculative, and a high markup will protect competitors from unfair, below-cost competition.

It is difficult to follow the logic in this rationale. As to the first sentence, it appears the majority is reasoning that low costs that arise because of high volume usage²³ (i.e., scale economies) are somehow problematic. If this statement means that the savings generated from efficiencies should not to be passed on to the consumer, then I strongly disagree. As to the statement that “a high markup will protect competitors from unfair, below-cost competition,” I have several comments. First, there is no evidence that MOL is below its costs. Second, if the statement means that the Postal Service proposal is below competitors’ costs, and this calls for a high markup, then we have precisely the sort of naked protectionism that is antithetical to the antitrust laws. Such reasoning represents a no-win situation for the Postal Service, for when it operates inefficiently it is routinely castigated, but when it discovers an efficient way to operate, its competitors are protected. This, to me, seems an unacceptable theory of regulation. Finally, the majority’s reasoning employs §3622(b)(4) *sub silentio*; use of this provision has grave legal problems, as discussed herein.

MASA’s Arguments on Competitive Effects

It can be agreed that there is no evidence that the Postal Service has taken away MASA member business simply because, except for a brief, anemic, and now defunct market test, this is a brand new business. Instead, the majority must rely on the assertions of MASA members that in the future their businesses will be materially harmed because they will not be able to compete on price, in part because the Postal Service enjoys tremendous institutional advantages, and puts forth its own economic analysis of the USPS’s supposed institutional advantages. I analyze each set of institutional arguments separately.

²³ Such low costs may also reflect internal efficiencies of the printers the Postal Service has contracted or will contract with.

Before proceeding to a discussion of MASA's arguments, it should be pointed out that MASA's brief also takes the position that the Postal Service's MOL operation is not likely going to succeed, contradicting its own fundamental assertions that its members face dire competitive consequences.²⁴

And, as [MASA witness] Prescott noted, nothing in the Market Test (or, in anything the Postal Service has done since – note that the commencement of the service is to be postponed yet again) suggests that the Postal Service can realistically achieve these volumes.

Further, witness Schuh states that there are “hundreds of other mailing firms around the country” performing services similar to his.²⁵ The sheer number of firms suggests that the industry is highly competitive (highly unconcentrated, in antitrust parlance), that there is a substantial amount of local business, and that there are minimal or no barriers to entry. A typical industrial organization economic analysis would undoubtedly verify that such an industry is competitively healthy²⁶ and not going to succumb to a well financed entrant, whether it be the Postal Service or UPS.

Whether or not these firms will suffer some measure of diversion cannot be known for sure at this juncture – MASA is asking us to speculate that substantial diversion will occur. And, as explained throughout my opinion, diversion of business does not equate to unfair competition. But there also exists the possibility that the Postal Service will develop this market, and MASA members in turn can capitalize on the Postal Service's efforts, e.g., getting a free ride on Postal Service advertising.²⁷ The services that MASA members perform hardly appear to be widely known to the public,

²⁴ MASA Initial Brief, at 40.

²⁵ Tr. 4/825.

²⁶ See, e.g., F.M. Scherer, *Industrial Market Structure and Economic Performance* (2d ed.), pp. 199-200, and 267 et seq.

²⁷ For a discussion of how “armies of imitators” capitalize on one firm's innovations, see generally T. Levitt, “Exploit the Product Life Cycle,” *Harvard Business Review*, Nov.-Dec. 1965, pp. 81-94. The same article discusses how even high quality products must be promoted through discounting upon introduction, an important point to remember when determining the appropriate price level for MOL.

and the Postal Service's national presence may in fact help these types of services to become commonly known.

Schuh's arguments that the Postal Service enjoys institutional advantages because of its size, legal status, and "deep pockets" has superficial appeal, but the advantages are not meaningful overall when scrutinized.²⁸ Schuh says his company cannot compete with the Postal Service's advertising efforts. "Because of its sheer size, USPS is able to advertise on a scale that companies like mine cannot even contemplate."²⁹ However, the Postal Service's direct advertising costs for MOL are attributed to the cost base of the product. The Postal Service cannot subsidize its direct advertising from other classes of mail. To the extent the Postal Service enjoys some scope economies in advertising because of its "brand name," are we to deny consumers what is usually considered a productive efficiency? UPS, Staples and Pitney Bowes, three potential MOL competitors, have comparable brand name power. In our mixed economy of large and small businesses, we do not ban large companies from operating in certain sectors because they operate under economies of scale and scope. Consumers enjoy the savings generated from such economies. I would add that there is nothing to prevent groups of MASA members from collaborating in such efforts as advertising, marketing, joint purchasing, etc., in order to achieve similar economies. Joint ventures of this type are conducted lawfully and commonly in our economy without raising antitrust concerns.

The general assertion that big firms can operate more efficiently than small firms and outcompete them is simplistic. "In nearly all production and distribution operations, the realization of scale economies appears to be subject to diminishing returns."³⁰ In fact, diseconomies may set in with large size so that there is a U-shaped long run cost

²⁸ Tr. 4/826 *et seq.*

²⁹ Tr. 4/826. Of course if one derives most of one's business from a local area, there is no need to advertise on a broad scale, and targeted demographic marketing is likely quite economic.

³⁰ Scherer, *supra*, at 84.

curve, especially where large size brings with it a large management bureaucracy.³¹ Cost-scale relationships are difficult to assess,³² and no such detailed assessment has been made here.

Schuh also complains that USPS pricing assumptions are unrealistic because it has priced its service "as if data will be received in a consistent and highly accurate form and there will be little need for direct interaction with the customer."³³ Schuh says the USPS's proposed operation will not be able to address the many issues between printer and customer that arise. However, Schuh seems to be pointing out a comparative advantage that MASA members will have over the Postal Service – the ability to provide personalized service with attention to detail. MASA's members should be proud of their own successful record of rapid technological innovation, flexibility, and efficiency. Schuh's argument also undercuts the majority opinion's assertion that MOL is a high-value service.³⁴

Schuh's price competition argument also is undercut by his assertion that a significant part of his firm's costs are associated with servicing clients.³⁵ One can assume that if customers value the quality of service provided they will continue doing business with his firm. If they desire a lower level of quality at a lower price, perhaps MOL will be a better alternative. Consumers should not have to pay for services they do not want. Comparing costs for services with different features and quality levels is highly problematic. We surely should not be basing prices for MOL on a comparison with service that may be of higher quality and therefore more costly.

³¹ Id. at 84 *et seq.*

³² Id. at 93 *et seq.*

³³ Tr. 4/829.

³⁴ Opinion at 69.

³⁵ Tr. 4/829.

Schuh also argues that the Postal Service enjoys an unfair advantage because it is exempt from many taxes.³⁶ However, the bulk of MOL's costs are printing contract costs (which we are marking up to form the final rates). That printing, in turn, is done by private sector firms that must pay taxes. So, for the bulk of MOL's cost base, the Postal Service has no tax advantage.

MASA does not mention the regulatory disadvantage under which MOL will operate. The Postal Service's offering has been scrutinized by competitors, in minute detail. Cost details, operational considerations, marketing ideas – all have been laid bare for the public to see. The Postal Service's competitors can profit highly from this dissection in their own efforts.³⁷ Second, the Postal Service's MOL proposal is essentially frozen. If it should decide that it needs a fundamental change in operations or prices, it must come back to the Commission for another public regulatory review. It cannot respond to operational innovations or price cuts from competitors except after going through another protracted administrative process. Indeed, standard marketing texts are awash with strategies on how firms can respond to competitive pressures – many of which are closed to the Postal Service, which operates in regulatory handcuffs.

Therefore I disagree with the Commission's assessment that the Postal Service has tremendous institutional advantages that must be dealt with by imposing higher prices.³⁸ The majority opinion seems to view the Postal Service's large size as a guarantor of success, but it is common knowledge that large, prominent firms fail all the time and hitherto small and unknown firms rise to prominence. Remember, Microsoft once was small. It is a matter of public record that the Postal Service has not been successful with some of its product innovations. It also is a matter of record that the Postal Service has not been successful in competing with private firms at times (e.g.,

³⁶ Tr. 4/830.

³⁷ See Levitt, *supra*.

³⁸ "The Postal Service has great economic power and vast resources at its disposal in comparison to most, if not all, potential Mailing Online competitors." Opinion at 33.

the parcel business). Further, the majority's focus on the Postal Service's financial girth ignores an important principle of competition analysis -- notions that there is something inherently bad about large firms engaging in vigorous competition have been rejected by the Supreme Court: "It is in the interest of competition to permit dominant firms to engage in vigorous competition, including price competition."³⁹

The majority also states that the Postal Service "does not have a requirement to ever produce a profit"⁴⁰ which when coupled with the "institutional contributions derived from the monopoly products" . . . "allows the Postal Service to take financial risks that would be otherwise unacceptable in the private sector."⁴¹ I agree that the Postal Service is not disciplined by market forces in the same way as private firms are (e.g., from stockholders). I have already spoken of the substantial regulatory constraints that make product innovation troublesome for the Postal Service. But the statement that the Postal Service can take risks private sector firms cannot is unsubstantiated and probably false. If it were true, the Postal Service would not have withdrawn from new business ventures which turned out unpromising (e.g., retail sales of coffee mugs, etc.). In fact, this product innovation, like others that have come under our rate and classification scrutiny, have been modest extensions of the Postal Service product line.

³⁹ *Atlantic Richfield Co. v. USA Petroleum Co.*, 495 U.S. 328, 341 (1990), and other cases cited therein.

⁴⁰ The issue of how non-profit institutions operate as compared to their for-profit counterparts is both complex and highly controversial, see, e.g., Wm. Lynk, "Nonprofit Hospital Mergers and the Exercise of Market Power," *Journal of Law & Economics*, Vol. 38 (1995), 437-61. One cannot merely assert that non-profit institutions behave more recklessly in an economic sense. In my employment with non-profit organizations (museums and educational institutions) I did not experience such institutions engaging in irrational economic behavior merely because they were non-profit. For one thing, many non-profit institutions may internalize what would otherwise be classified as accounting-type profits, e.g., in the form of granting generous employee compensation (either in the form of high salaries or good benefits such as reduced work schedules). This internalization process may partially explain the purported wage premium enjoyed by Postal Service employees. "There is broad agreement in the literature that the Postal Service pays a substantial wage premium over the private sector . . ." Wachter and Perloff, "A Comparative Analysis of Wage Premiums and Industrial Relations in the British Post Office and the United States Postal Service," in Crew and Kleindorfer (ed.), *Competition and Innovation in Postal Services*, p. 119. Furthermore, non-profits are subject to political oversight, which serves to temper behavior, e.g., a museum by its board and contributors, and the Postal Service by Congress.

⁴¹ Opinion at 33.

One can hardly call MOL a risky innovation when hundreds of firms (MASA members) are offering similar services. Private sector firms, in contrast, can and do enter entirely new markets far removed from their traditional lines of business.

The majority opines that the printer contracts with their minimum volume requirements and guaranteed payments are an example of the type of financial risk that would be unacceptable in the private sector.⁴² It then states:⁴³

The other effect of the minimum payment is to allow the Postal Service to secure a favorable printing price based on a guaranteed high volume of printing. The result is printer prices below what the competition can offer. * * * Therefore, the Commission cannot dismiss the potential for harm caused by indirect competition with the Postal Service.

This reasoning is internally contradictory. On the one hand, the majority is saying that the printer contracts are an example of risky behavior on the part of the Postal Service, but on the other hand that the contracts may prove *too* advantageous for the Postal Service. The majority cannot have it both ways. In fact, so-called minimum requirements contracts are common in the private sector, employed to assure vendors that their investment in equipment or realignment of their services is prudent.⁴⁴ From my vantage, such contracts seem eminently reasonable as a way to attract contractor services. The majority's castigation of a commonly-employed type of contract seems especially unwise when one considers that courts have a dim view of the Commission intruding upon Postal Service management decisions,⁴⁵ which is exactly what the majority opinion accomplishes.

I find it ironic that in its well-meaning attempt to protect one set of small businesses, the majority will accomplish this by requiring other small businesses (or

⁴² "For example, Mailing Online printer contracts contain minimum payment provisions regardless of volume." Opinion at 34.

⁴³ Opinion at 34.

⁴⁴ Long distance telephone calling plans with monthly fees and inexpensive time-based rates are but one example of a minimum requirements contract which consumers use directly.

⁴⁵ See, e.g., *Newsweek, Inc. v. U.S. Postal Service*, 663 F.2d 1186, 1203 (2d Cir. 1981).

“SOHOs”) who wish to use MOL to pay higher fees. The majority opinion may result in another irony here. By setting the fees higher than requested, if MOL fails, the Postal Service will be able to avoid responsibility for its own management of the new service and instead cast blame on the Commission.

Correct Market Analysis Needs to Be Performed When Analyzing Competitor Complaints

Witness Schuh’s review of MOL’s proposed pricing structure leads him to conclude that it will be impossible for his company to compete with it.⁴⁶ He states that his company’s selling costs, excluding postage, run from 50% above Mailing Online on larger quantities to 250% above Mailing Online on small quantities.⁴⁷

However the antitrust issue that we should concern ourselves with is that of predatory pricing, i.e., *below-cost* pricing “for the purpose of eliminating competitors in the short run and reducing competition in the long run.”⁴⁸ In *Brooke Group v. Brown & Williamson Tobacco Corp.*, the Supreme Court set forth the twin elements that must be proved in a predatory pricing case:⁴⁹ a plaintiff seeking to establish competitive injury resulting from a rival’s low prices must prove that the prices complained of are below an appropriate measure of its rival’s costs, and that the alleged predator has a dangerous probability of recouping its investment in below-cost prices. The Court noted:⁵⁰

Recoupment is the ultimate object of an unlawful predatory pricing scheme; it is the means by which a predator profits from predation.⁵¹ Without it, predatory pricing produces lower aggregate prices in the market, and consumer welfare is enhanced. Although unsuccessful

⁴⁶ Tr. 4/829-30.

⁴⁷ Tr. 4/829.

⁴⁸ *Cargill, Inc. v. Monfort of Colo., Inc.* 479 U.S. 104, 117 (1986).

⁴⁹ 509 U.S. 209, at 222 and 224.

⁵⁰ *Id.* at 224.

⁵¹ The Postal Service is an especially poor candidate for even attempting predation because its rate requests during the so-called recoupment period would be reviewed by this Commission.

predatory pricing may encourage some inefficient substitution toward the product being sold at less than its cost, unsuccessful predation is in general a boon to consumers.

And, as the Federal Trade Commission, one of two federal agencies that enforces our nation's antitrust laws, has noted:⁵²

A common complaint is that some companies try to monopolize a market through "predatory" or below-cost pricing. This can drive out smaller firms that cannot compete at those prices. But the lower prices a large retailer offers may simply reflect efficiencies from spreading overhead costs over a larger volume of sales. Because the antitrust laws encourage competition that leads to low prices, courts and antitrust authorities challenge predatory activities only when they will lead to higher prices.

I am concerned that uncritical acceptance of competitor complaints about Postal Service pricing will chill competition and innovation. There is no market analysis in the Opinion about possible entry barriers (although the Commission's decision acknowledges that there has been entry). Nor does the opinion analyze whether the public has possible substitutes to turn to if the Postal Service was able to drive out existing competitors (even though 39 U.S.C. §3622(b)(5) requires the Commission to consider the available alternative means of sending and receiving letters and other mail matters at reasonable cost).

Further, we need to look at such issues as the downward pressure on prices that competition from the Postal Service would bring to the market and the improvements in product/or service which other entrants such as UPS, Pitney Bowes, etc., might make to compete with MOL.

It is imperative that we evaluate possible consumer responses to price increases (such as substituting similar products) should MOL prevail as the dominant product. As to potential MOL substitutes, I think we should adopt the type of product market analysis used by antitrust authorities, such as the product market definition used in the

⁵² Federal Trade Commission, "Promoting Competition, Protecting Consumers: A Plain English Guide to Antitrust Laws," available on the internet at <http://www.ftc.gov/bc/compguide/index.htm>.

Department of Justice and Federal Trade Commission Horizontal Merger Guidelines (1992). A price increase after the elimination of competition could be made unprofitable for the alleged predator (the Postal Service) by consumers switching to other products.⁵³ Indeed, in asking whether, for example, SOHO's could readily substitute other products⁵⁴ such as developing their own mailings on home computers using commonly available desktop publishing, running newspaper ads, using non-print media such as local cable, using targeted mailing available from marketing firms, etc., I am struck by the lack of participation in this case by parties that might offer SOHO's other ways to disseminate information.

The Commission has substantial experience and expertise in evaluating the various ratemaking factors under 39 U.S.C. 3622 in permanent cases, but relatively little with experimental cases. Practically speaking, it is a common practice in retailing to offer introductory prices so that one attracts new customers. It also is common knowledge that in retailing one can expect losses for a fairly long period until the business or product becomes established. One only has to look at how the stock market values some start-up firms that operate at losses in their formative period. The Postal Service is asking the Commission for nothing more than normal, ordinary operational flexibility.

⁵³In considering the likely reaction of buyers to a price increase, the antitrust agencies take into account such evidence as: (1) evidence that buyers have shifted or have considered shifting purchases between products in response to relative changes in price or other competitive variables; (2) evidence that sellers base business decisions on the prospect of buyer substitution between products in response to relative changes in price or other competitive variables; (3) the influence of downstream competition faced by buyers in their output markets; and (4) the timing and costs of switching products. In attempting to determine objectively the effect of a "small but significant and nontransitory" increase in price, the antitrust agencies generally will use a price increase of five percent lasting for the foreseeable future.

⁵⁴A product market definition should include products that are reasonably interchangeable in use. See the discussion of Product Market Definition in ABA Section of Antitrust Law, *Antitrust Law Developments* (4th ed. 1997), at 499 *et seq.* On the supply side, courts look to the ability of producers to switch production capabilities. *Id.* at 516-19. Defining a product market too narrowly erroneously magnifies perceived competitive risks. See, e.g., *United States v. E.I. du Pont de Nemours & Co.*, 351 U.S. 377, 394 (1956). It is likely that the majority's product market definition is too narrow.

The Commission in part bases its increase of the markup and the fee schedule above that recommended in Docket No. MC98-1 on the three-year length of the experiment and the permanent harm that might result to MASA members. I am not concerned about using the USPS's proposed 30% markup during the full length of the experiment. In discussing promotional pricing, the Areeda-Hovenkamp antitrust treatise notes the FTC's decision in *General Foods*, 103 FTC 204 (1984) "where the FTC concluded that three years of below-cost pricing by a firm with a 24 percent market share qualified as promotional."⁵⁵ In *Brooke Group*, the alleged below cost pricing went on for 18 months. There is simply no credible legal reason or market evidence to justify the belief that competitors will suffer lasting or permanent harm during the life of this experiment.

Even if I shared the misgivings expressed by the majority about the susceptibility of the future market to Postal Service competition, I am reassured by the fact that after this experimental phase, the Postal Service must return to the Commission for a permanent rate that might require a higher markup. At that point, we would have a realistic opportunity to examine the effects of the Postal Service's proposed pricing scheme on the market and consider raising rates if the lower rates created more harm than good.

The "Value of Service" Criterion and Volume Issues

I disagree with the majority's application of the "value of service" criterion.⁵⁶ The relevant subsection of §3622(b) tells us to consider:

(2) the value of the mail service to both the sender and the recipient, including but not limited to the collection, mode of transportation, and priority of delivery.

⁵⁵ Areeda and Hovenkamp, *Antitrust Law*, Vol. 3, at 447, n.2.

⁵⁶ Opinion at 69-70.

First, it is important to remember that MOL is a printing and collating service (via computer), after which the MOL customer will be charged an appropriate postage fee. The decision correctly separates out the fact that MOL is designed as a convenient method to enter mail into the mailstream. The mailstream portion of the service is covered by the postage fee, which will be marked up in conformance with statutory criteria applied in the last omnibus rate case, and the markups for MOL's postage fees are themselves relatively high.⁵⁷

The majority states MOL provides a high value of mail service to the sender and recipient of the mail, and concludes this justifies a high markup.⁵⁸ The opinion then describes the attributes of MOL that allegedly manifest this high value, e.g., allowing the sender to use a personal computer, entry of mail close to final destination, etc. The Commission did not discuss this "high value" in its market test opinion, which set the cost coverage at 125 percent. Much of the evidence, moreover, contradicts this conclusion of "high value."

Regarding value to the sender, MASA itself portrays the MOL service as incapable of providing personalized service,⁵⁹ a point with which the majority opinion agrees, noting that MOL "offers only a limited number of options to the customers."⁶⁰ "The Commission views customer service as an important distinction between Mailing Online and the alleged competition. "Customer service is an important part of the product being offered by witnesses Schuh's and Jurgena's businesses that Mailing Online does not offer. This may account for a portion of the higher prices being charged by their businesses."⁶¹ MOL's electronic component makes it high in quality in

⁵⁷ Opinion at 17: "Automation basic rates incorporate a substantial markup . . ."

⁵⁸ Id. at 69-70.

⁵⁹ Tr. 4/829.

⁶⁰ Opinion at 31.

⁶¹ Opinion at 32.

terms of collection and mode of delivery,⁶² but I view the overall value of service MOL would provide as a cut-rate printing and collating service, perhaps not even up to the level commonly provided by MASA members.

As to the value to the recipient, not discussed by the majority, it should be comparable to the lower value of advertising mail, and therefore should call for a low markup.

The majority also concludes that the “uncertainty of volume and cost estimates makes it appropriate to attach a high markup to Mailing Online, thereby reducing the likelihood that this service will fail to meet the requirement that it recover attributable costs.”⁶³ Note, though, that in its market test opinion, when establishing a 125 percent markup, the Commission concluded:⁶⁴

As Mailing Online is configured, a high proportion of its costs are incurred on a unit basis. As a result, the risks that expected volumes will not be realized, and that start up costs will not be recovered and have to be borne by other classes of mail is minimized.

I would also point out that the Commission there found:⁶⁵

The Postal Service argues that because Mailing Online is a price sensitive experimental service in its start up phase, a markup somewhat below the average for mature classes is appropriate. The Postal Service argues that it will help this nascent service find its market and build volumes to the level that will support reasonable judgments about the nature of the

⁶² Opinion at 70. However, I disagree with the majority’s assertion that “the collection and mode of transportation for Mailing Online will be superior to that of any other postal product . . .” Ibid. MOL users will be generating a limited type of mass-produced mail pieces. MOL can not be used for many types of documents and cannot be used for parcels. So, e.g., if I wish to send out an important legal document expeditiously, the mode and collection of delivery of Express Mail is a type of high value service I might opt for. Or, I may wish a Priority Mail parcel to be picked up. One simply cannot compare MOL mass-production pieces with many other types of mail.

⁶³ Opinion at 71. The majority also worries that the volume projections “were developed a number of years ago . . .” Id. at 70. However, the competitive analysis done by MASA was submitted in February of 1999. The Commission itself has performed no market analysis of the industry at any time, which weakens its argument that the volume projections supplied are dated.

⁶⁴ Docket No. MC98-1, Market Test Opinion at 31.

⁶⁵ Id. at 32-33.

market and the future viability of the service. [citation omitted] *The Commission concludes that these are reasonable grounds for recommending the 25 percent markup requested.* [emphasis added]

The Commission's opinion here not only contradicts its market test assertions about MOL, but also contradicts orthodox economic thinking. If demand for MOL is elastic (and the finding that MOL "is a price sensitive experimental service" seems to state that), then raising its price may lower the total dollar revenue produced. It is not surprising, then, that in discussing the value of service criterion, the majority opinion fails to take into account an important aspect of value of service, the degree to which service usage declines in responses to price increases. Although we have no historical record to assess own-price elasticity directly, MOL appears to be highly price sensitive, calling for a very low markup. The record is clear that there are a large number of printers who offer similar (and perhaps superior) printing and collating services, any one of whom can deposit mail at the variety of discount postage rates available.⁶⁶ But the competition for MOL is broader than this. The largest potential application by users probably will be short-run direct mail advertising and solicitation from individuals, small businesses, home offices, and charitable organizations.⁶⁷ There appear to be a plethora of alternatives for MOL's potential users to convey their messages if MOL is perceived as not cost effective. These include other forms of media (including media that can employ narrow demographic distribution), more traditional kinds of Standard A mail preparation services, self-preparation of documents, web site advertising, etc.⁶⁸ Therefore, contrary to the majority opinion's § 3622(b)(2) analysis, I find that this criterion strongly supports a low markup.

⁶⁶ MASA is a trade association of about 500 members, and PII is a trade association of about 2000 small printers and copy shop members. Opinion at 28.

⁶⁷ Opinion at 2.

⁶⁸ Compare the cost coverage analysis accorded Standard A Regular Mail in Docket No. R97-1, Opinion at 434-35. In adopting a 135 percent cost coverage, the decision seems to accept the Postal Service analysis that even though the mail is capable of demographic targeting, it has major competitors, including special interest magazines, local cable, and internet web sites.

The majority opinion also is at odds with its treatment of cost coverage for delivery confirmation in Docket No. R97-1. In approving an overall cost coverage of 107 percent,⁶⁹ the Commission recognized this as low because, inter alia, "the quality of the service is untested."⁷⁰ Here the service also is substantially untested, though the majority complains that the evolving nature of the service lends to the uncertainty of volume projections.⁷¹ Further, in R97-1 the Commission stated as to Priority Mail manual delivery confirmation that a low markup was justified because it "should further increase Priority Mail volumes" which were recognized as making a "large contribution."⁷² Here, MOL should attract more mail to classes which already have high markups.

The Cost Attribution Issue

While the Postal Service's proposal to add 0.1¢ to each piece (or impression) to cover attributable costs understates some costs, in particular, credit card fees which have been identified in the evidentiary record presented in this case, the Commission majority has, in my opinion greatly overestimated other costs.

In choosing to recognize more than \$30 million in product-specific Information Technology expenditures as attributable, the majority included \$9.6 million that has already been spent in anticipation of the experiment phase and would, if the experiment were not permitted to continue, be accounted for by the Postal Service as general institutional research and development costs. Further, the \$20.7 million the Service anticipates investing in Information Technology for MOL during the experiment can either be considered (1) as an investment in the information network infra-structure of a 21st century Postal Service and, therefore, as institutional costs or (2) as expenditures

⁶⁹ R97-1 Opinion at 585.

⁷⁰ Ibid.

⁷¹ Opinion at 72.

⁷² R97-1 Opinion at 585.

that should be incorporated into rates for recovery if and when MOL becomes permanent. Moreover, when the sum of the estimated total attributable costs amounted to 0.42¢ per impression, the majority rounded up to 0.5¢, resulting in a 400% increase over the Postal Service's proposal. I would suggest eliminating the \$30 million and rounding down. Simply put, the PRC recommended 52% markup on these attributable costs would amount to a final rate of 0.75¢ per impression as opposed to the 0.13¢ per impression requested – a 477% increase.

The Commission also fails to consider two important factors contributing to MOL revenues. First, the great bulk of the costs being attributed, and then marked up, are printing costs which are the result of contracts between the Postal Service and private sector firms. These are passthroughs that cost the Postal Service nothing. If one views MOL essentially as the Postal Service being an agent for a consortium of printers, who in turn use the USPS internet portal, then it is questionable why the markup should apply to those printing costs at all. The problem is that when nearly all of the costs are contract costs, even a moderate markup has the potential to put rates above what economists call "stand-alone costs." Rates above stand-alone costs involve cross subsidy. All of the literature views stand-alone costs as an upper limit. There is no reason to view traditional markups as applicable in a situation like this. Second, the postal rate recommended for MOL, (the basic automation rate to which all parties in the case have stipulated), already includes a substantial markup.

The Public Will Benefit From A Lower Priced Service

I fear that the Commission's imposition of a higher markup and higher attributable costs than that proposed may persuade the Postal Service not to offer this service (and may deter it from returning to the Commission with other proposals). That would be very unfortunate, for MOL could benefit the public in a variety of ways. The

many benefits cited by the Commission when it approved the earlier MOL market test⁷³ bear repeating here:

There is also a reasonable expectation that Mailing Online will substantially benefit individual, home office, and small-volume business mailers by simplifying their interface with the Postal Service's complex rates and regulations [consistent with § 3622(b)(7)], reducing their transaction costs [consistent with § 3622(b)(2)], and making it feasible for them to take advantage of automation and drop ship discounts that previously have been used predominantly by large volume mailers [consistent with § 3623(c)(1), (3), and (5)]. It also appears that it has the potential to speed delivery of the mail [furthering § 3623(c)(3)], and to attract significant new volumes of high quality, low-cost mail to the Postal Service. This is likely to make the Postal Service a more viable participant in the rapidly evolving communications market.

Mailing Online therefore has the potential to fulfill several of the most basic mandates that the Act imposes on the Postal Service. It holds out the promise of helping preserve the Postal Service as a "basic and fundamental" public service, that can "bind the Nation together through the personal, educational, literary, and business correspondence of the people" and of extending "prompt, reliable, and efficient services to patrons in all . . . communities" through the internet, in furtherance of § 101(a). Making electronic access available to small businesses and other small organizations, and perhaps even to individuals, is likely to help the Postal Service provide "the most expeditious collection, transportation, and delivery" [§ 101(e)], and to help it give the "highest consideration to the prompt and economical delivery of all mail." [§ 101(f)]

If Mailing Online proves to be a viable service, it has the potential to help "maintain an efficient system of collecting, sorting, and delivering mail nationwide" as required by § 403(b)(1). It therefore appears that the basic features of Mailing Online could significantly aid the Postal Service in its pursuit of the fundamental goals of § 403(a), which requires the Postal Service "to plan, develop, promote, and provide adequate and efficient postal services at fair and reasonable rates and fees." Accordingly, the Commission finds that, on balance, it is in both the public's interest and the Postal Service's interest to allow Mailing Online to be offered briefly in

⁷³Docket No. MC98-1, Market Test Opinion at 34-35.

a limited market as a step in determining whether it is likely to realize this potential.

Conclusion

I urge the Board of Governors to adopt the Commission's majority decision on Docket No. MC2000-2 under protest, allow the recommended decision of the Commission to take effect and return the recommended decision to the Commission for a prompt reconsideration and a further recommended decision with regard to rates.

SEPARATE OPINION OF CHAIRMAN GLEIMAN, VICE CHAIRMAN OMAS,
COMMISSIONER COVINGTON, AND COMMISSIONER LEBLANC

Our colleague, Commissioner Goldway, has included extensive separate views in support of recommending lower Mailing Online fees. We feel constrained to attempt to identify and clarify the limited areas of disagreement between us. The entire Commission concludes that Mailing Online should be offered to the public, but we recommend that a typical piece pay 40.9 cents (including First-Class postage) while our colleague would recommend 37.9 cents.

Our colleague suggests that the Commission should not recommend markups, cost attributions, or rates that are higher than those requested by the Postal Service except in very limited circumstances. Goldway Op. at 1. We think such a policy would improperly abdicate our responsibilities both to the Board of Governors, and to mailers.

The majority applies existing costing methodology, and increases fees to recover about 3/10 of a cent of product specific information technology costs that the Postal Service proposal fails to attribute. Commissioner Goldway suggests that certain attributable costs incurred during this experiment need not be recovered from users.¹ We strongly disagree.

The majority determines that Mailing Online should make a contribution to institutional costs that is lower than the markup on First-Class Mail, but higher than the markup on Standard A Regular (formerly third class). Commissioner Goldway favors a markup at [or below] the level proposed by the Postal Service (slightly below Standard A).

This difference stems from interpretations of how the evidence before us relates to the policy criteria in 39 U.S.C. § 3622 that we apply to set rates. The majority concludes that the premium collection and transportation of Mailing Online give it a high intrinsic value of service [3622(b)(2)]. Commissioner Goldway characterizes Mailing

¹ Commissioner Goldway suggests treating these costs as “an investment in the information network infra-structure of a 21st century Postal Service and, therefore, as institutional costs”. Goldway Op. at 23. She further suggests that the remaining non-Printer attributable costs be rounded down. *Id.* at 24. Taken together, this produces a per-impression fee of zero cents. She also questions whether any markup should be applied to Printer costs. *Ibid.*

Online as “a cut-rate printing and collating service” with a relatively low value to senders. *Compare* PRC Op. at 69-70 with Goldway Op. at 20-21.² She then states recipients will view Mailing Online as having “the lower value of advertising mail”. This despite the fact it may be used for First-Class, Priority, and Express mailings as well as for Standard A pieces. Moreover, we know of no record evidence to support her characterization of recipients’ perceptions.

The majority also concludes that the speculative nature of the volume projections offered by the Postal Service, based as they are on a five year old survey for a different product, make it quite possible that costs [3622(b)(3)] will have to be spread over fewer pieces than the Service estimates. Therefore it increases the markup for Mailing Online to assure that monopoly users and private businesses are not unfairly disadvantaged by this. Commissioner Goldway disagrees. (*Compare* PRC Op. at 71 with Goldway Op. at 9.)

Anti-trust laws are not a significant factor in the fees recommended for Mailing Online, although the recommended fees are consistent with the policies fostered by those laws. The majority decision discusses anti-trust issues because two intervenors, Mail Advertising Service Association, International and PrintImage International argue that under these principles, the Commission should not recommend the establishment of a Mailing Online experiment. The majority rejected these arguments. So does Commissioner Goldway.

Commissioner Goldway believes that in general, both potential users and competition as a whole benefit when services are offered at lower prices. She expresses concern lest “uncritical acceptance of competitor complaints” chill competition and innovation. Goldway Op. at 17. We can agree with these as general propositions. However, we reject any implication that any of the Commissioners have

² Although there is no evidence that similarly-priced substitutes exist, and Commissioner Goldway acknowledges there is no record to assess elasticity, she nonetheless also finds Mailing Online “appears to be highly price sensitive”. Goldway Op. at 22.

accepted parties' arguments uncritically and, as a consequence, recommended higher fees.

Our colleague's separate opinion cites several court interpretations of anti-trust laws that identify behavior not prohibited by statute. We caution that rules applicable to competition between free market enterprises that must risk private capital and answer to investors seeking to earn profits, may not be directly applicable when one competitor is a government entity that by law must be reimbursed by captive customers for any losses it incurs. The Postal Service generates \$50 billion a year in monopoly revenues from which it draws its "risk" capital. We are not convinced that individual mailers, or the nation's consumers as a whole, would benefit if the Service is treated as just another competitor in private markets.

In this instance, when balancing the statutory policy factors, the majority did not accord the theoretical benefits of a lower rate as much weight as did our colleague. To the extent Commissioner Goldway believes that the recommended fee level is intended to further some other, unstated policy, she is mistaken.³

Our colleague includes a lengthy quotation from the Commission's opinion in Docket No. MC98-1 that identifies the potential benefits of Mailing Online.⁴ We also continue to agree with that analysis. We sincerely hope that the current version of Mailing Online will facilitate the generation of mail through the internet. However, we have concluded that under our law, the fees for the three year nationwide test of Mailing Online should include a higher markup than the fees for the earlier, geographically-limited market test that was expected to be in effect for only a few months.

³ We see no purpose to extended rebuttals to the several straw man arguments such as "I do not think the proper interpretation of § 3622(b)(4) is to protect competitors at all costs." Goldway Op. at 5. We are aware of no Commissioner or party that supports such an interpretation.

⁴ In that unique docket, the Postal Service filed a single request seeking expedited authorization to conduct both a local market test of Mailing Online (recommendation sought within 90 days), and to immediately follow that test with a nationwide experiment (recommendation sought within 150 days). The cited opinion recommended the market test. The Postal Service then withdrew the second part of its request.

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Commissioner Covington, and Commissioner LeBlanc

Finally, nothing in the record of this case indicates to us that the slightly higher fee levels recommended by the majority will either impede the Service's entry into the hybrid mail arena, or have a significant impact on the success of this experiment.

RECOMMENDED CHANGES IN RATE AND FEE SCHEDULES

The following represent the Postal Rate Commission's recommended changes to the Rate and Fee Schedules of the Domestic Mail Classification Schedule in response to the Postal Service's Request for a Mailing Online experiment. In the notes to Schedule 221, First-Class Mail, proposed additions are underlined and proposed deletions are in brackets. In the notes to Schedule 222, First-Class Mail, proposed additions are underlined; there are no deletions. Fee Schedule 981, Mailing Online, contains new material, and replaces the current Fee Schedule 981 in its entirety. In Schedule 1000, proposed additions are underlined.

FIRST-CLASS MAIL

* * * * *

SCHEDULE 221 NOTES

* * * * *

³ Rates apply to bulk-entered mailings of at least 500 letter-size pieces, which must be delivery point barcoded and meet other preparation requirements specified by the Postal Service and, for the Basic Presort rate, documents provided for entry as mail using Mailing Online or a functionally equivalent service, pursuant to section [Fee Schedule]981.

* * * * *

⁸ Rates apply to bulk-entered mailings of at least 500 flat-size pieces, each of which must be delivery[-]point barcoded or bear a ZIP+4 barcode, and must meet other preparation requirements specified by the Postal Service, and, for the Basic Presort rate, to documents provided for entry as mail using Mailing Online or a functionally equivalent service, pursuant to section [Fee Schedule]981.

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FIRST-CLASS MAIL

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SCHEDULE 222 NOTES

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² Rates apply to bulk-entered mailings of at least 500 pieces, which must be barcoded and meet other preparation requirements specified by the Postal Service and, for the Basic Presort rate, to documents provided for entry as mail using Mailing Online or a functionally equivalent service, pursuant to section 981.

* * * * *

FEE SCHEDULE 981

MAILING ONLINE

Description

Fee

Fees are calculated by multiplying 1.52 times the sum of printer contractual costs for the particular mailing and 0.5 cents per impression for other Postal Service costs.

1.52 x (P + 0.5¢ x I)

P = Printer Contractual Costs

I = Number of Impressions

This provision expires 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.

FEE SCHEDULE 1000

	Fee
* * * * *	
Authorization to Use Bulk Parcel Return Service	\$100
<u>Certification of a system as functionally equivalent to Mailing Online.¹</u>	<u>\$100</u>

SCHEDULE 1000 NOTES

- ¹ This provision expires the later of:
- a. three years after the Mailing Online 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.

RECOMMENDED CHANGES IN THE DOMESTIC MAIL CLASSIFICATION SCHEDULE

The following changes represent the changes to the Domestic Mail Classification Schedule recommended by the Postal Rate Commission in response to the Postal Service's Request for a Mailing Online experiment. Proposed additions are underlined and proposed deletions are in brackets.

**EXPEDITED MAIL
CLASSIFICATION SCHEDULE**

* * * * *

160 **ANCILLARY SERVICES**

* * * * *

e. Mailing Online 981

* * * * *

**FIRST-CLASS MAIL
CLASSIFICATION SCHEDULE**

* * * * *

221.31 **General.** The automation rate categories consist of Letters and Sealed
Parcels subclass mail weighing 13 ounces or less that:

- a. Is prepared in a mailing of at least 500 pieces, or is provided for
entry as mail using Mailing Online or a functionally equivalent
service, pursuant to section 981;

* * * * *

222.41 **General.** The automation rate categories consist of Cards subclass mail
that:

- a. Is prepared in a mailing of at least 500 pieces, or is provided for
entry as mail using Mailing Online or a functionally equivalent
service, pursuant to section 981;

* * * * *

**STANDARD MAIL
CLASSIFICATION SCHEDULE**

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321.231 **General.** The automation rate categories apply to Regular subclass mail that:

- a. Is prepared in a mailing of at least 200 addressed pieces or 50 pounds of addressed pieces, or is provided for entry as mail using Mailing Online or a functionally equivalent service, pursuant to section 981;

* * * * *

321.431 **General.** The automation rate categories apply to Nonprofit subclass mail that:

- a. Is prepared in a mailing of at least 200 addressed pieces or 50 pounds of addressed pieces, or is provided for entry as mail using Mailing Online or a functionally equivalent service, pursuant to section 981;

* * * * *

364 **Regular**
[The following service may be obtained in conjunction with mail sent under this classification schedule upon payment of the appropriate fees:]Regular subclass mail will receive the following additional services upon payment of the appropriate fees:

	Service	Schedule
a.	Mailing Online	981

* * * * *

365

Nonprofit

Nonprofit subclass mail will receive the following additional services upon payment of the appropriate fees:

	<u>Service</u>	<u>Schedule</u>
a.	<u>Mailing Online (starting on a date to be specified by the Postal Service)</u>	<u>981</u>

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**SPECIAL SERVICES
CLASSIFICATION SCHEDULE**

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980 **ACCEPTANCE ALTERNATIVES**

981 **MAILING ONLINE**

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981.2 **[Description of Services]Availability**

981.21 Mailing Online is available for documents submitted in an electronic form, along with an address list, to be entered under the following classification schedules:

a. Express Mail;

[a.].b. First-Class Mail;

[b.].c. Regular and Nonprofit subclasses of Standard Mail.

- 981.22 Except as provided in section 981.23, d [D]ocuments presented through Mailing Online are eligible for only the following rate categories:
- a. Express Mail Next Day Service and Second Day Service
 - [a.]b. First-Class Mail Letters and Sealed Parcels Automation Letters Basic
 - [b.]c. First-Class Mail Letters and Sealed Parcels Automation Flats Basic
 - d. First-Class Mail Cards Automation Basic
 - e. First-Class Mail Single-Piece Priority Mail
 - [c.]f. Standard Mail Regular Automation Basic Letters
 - [d.]g. Standard Mail Regular Automation Basic Flats
 - h. Standard Mail Nonprofit Automation Basic (starting on a date to be specified by the Postal Service)
 - i. Standard Mail Nonprofit Automation Basic Flats (starting on a date to be specified by the Postal Service)
- 981.23 That portion of a Mailing Online mailing consisting of pieces with addresses that cannot be made to meet Postal Service addressing requirements is not eligible for any Automation Basic rate categories, but instead may be sent, at the option of the Mailing Online customer, at the applicable single-piece rates for First-Class Mail Letters and Sealed Parcels, First-Class Mail Cards, or Priority Mail.
- 981.3 **Requirements of the Mailer**
- 981.31 Documents and address lists must be presented in electronic form, as specified by the Postal Service, through the [Postal Service's Mailing Online][[i]internet site specified by the Postal Service. Documents must be prepared using application software approved by the Postal Service.

981.4 **Other Special Services**

Other special services that are available in conjunction with the subclass of mail chosen by the Mailing Online customer are available for Mailing Online pieces only as specified by the Postal Service.

981.[4]5 **Fees**

981.[4]51 The fees for Mailing Online [service]are described in Fee Schedule 981.

981.6 **Functionally Equivalent Systems**

981.61 **General.** Mailpieces created by a system certified by the Postal Service to be functionally equivalent to Mailing Online are eligible for the same rate categories as Mailing Online mailpieces. Mailpieces created by a certified, functionally equivalent service are in no case eligible for rate categories providing larger discounts than Mailing Online mailpieces would receive.

981.62 **Definition.** A functionally equivalent system is one which is capable of all of the following, comparable to Mailing Online, as specified by the Postal Service:

- a. accepting documents and mailing lists from remote users in electronic form, such as via the Internet, or converting documents and mailing lists to electronic form;
- b. using the electronic documents, mailing lists, and other software including sortation software certified by the Postal Service that sorts to the finest level of sortation possible, to create barcoded mailpieces meeting the requirements for automation category mail, with 100 percent standardized addresses on all pieces claiming discounted rates;
- c. commingling mailpieces from all sources without diversion to any other system and batching them according to geographic destination prior to printing and mailing; and
- d. generating volumes that exceed on average any otherwise applicable volume minimums.

981.63 **Certification**

981.631 **General.** Functionally equivalent systems must meet the requirements for certification specified by the Postal Service.

981.632 **Fee.** Functionally equivalent systems are subject to the annual certification fee set forth in Fee Schedule 1000.

981.633 **Cancellation.** Certification can be cancelled by the Postal Service for failure to continue to meet the requirements of this section and those specified by the Postal Service.

981.[5]7 **Duration of Experimental Service Period[Market Test]**

981.[5]71 [The provisions of section 981 expire no later than implementation of an experimental Mailing Online service following acceptance or allowance by the Governors of the Postal Service of a recommended decision by the Postal Rate Commission, or no later than 3 months after issuance of a recommended decision by the Commission rejecting the Postal Service's request for an experimental Mailing Online service; or no later than 3 months after issuance of a decision by the Postal Service Governors rejecting a Commission recommended decision on an experimental Mailing Online service.]

The provisions of section 981 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.

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