Postal Rate Commission
Submitted 11/20/2006 4:06 pm
Filing ID: 55063
Accepted 11/20/2006

**GHS-ST-1**
**Docket No. R2006-1**

# SUPPLEMENTAL TESTIMONY

# OF

# CAMERON BELLAMY

# ON BEHALF OF

# GRAYHAIR SOFTWARE

**November 20, 2006**

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# SUPPLEMENTAL TESTIMONY OF CAMERON BELLAMY

## I. STATEMENT OF QUALIFICATIONS

My name is Cameron Bellamy. I am the President and partner in Grayhair Software, Inc. (GHS). I previously submitted direct testimony (GHS-T-1) in this case on September 6, 2006. My qualifications are stated in GHS-T-1.

## II. PURPOSE AND SCOPE

This testimony addresses issues relating to Confirm pricing brought up in the Presiding Officer's Information Request No. 12, questions 5, 6 and 7, issued August 24, 2006, and the replies to those questions by USPS witness Mitchum on September 7 and 8, 2006.

## III. POIR NO. 12, QUESTION 5, ASKS IF THERE IS AN ARBITRAGE POTENTIAL IMPLICIT IN THE EXISTING AND PROPOSED USPS CONFIRM PRICING SCHEDULES, THOUGH LITTLE OR NO ROLE IS PLAYED BY ARBITRAGE IN THE ACTUAL BEHAVIOR OF CONFIRM SUBSCRIBERS AND USERS

POIR No. 12 questions whether there is a potential for arbitrage in the current Confirm pricing schedule, as well as the USPS proposed pricing schedule and, implicitly, in the OCA proposal as well. The idea is apparently that a Confirm subscriber would purchase scans, or the right to receive such scans, and then resell the scans to other users at a price greater than what was paid for them but less than what the other users would have to pay.

USPS witness Mitchum responds to this question by explaining that Confirm resellers do not engage in a classical arbitrage involving purchase and immediate resale

to a third party. Rather, such resellers compete with each other for customers on a basis of adding value to the raw scans to meet specific customer needs. Concerning GHS in particular, USPS witness Mitchum states (Response to POIR No. 12, question 5, page 2) “I think their customers are not choosing an intermediary to receive a discounted price, but instead are using the intermediary for the value added services provided.” GHS appreciates the recognition of this point by the USPS.

Not only GHS, but other resellers as well, seek to obtain customers through adding value to the raw Confirm scans. As GHS stated in its prior testimony:

> Among the Platinum Confirm service providers, there are a variety of business models designed to appeal to different segments of the market. GHS aimed to provide multi-year storage capacity with customized reports, providing fast turnaround in a highly secure environment. Others emphasized providing large numbers of customers with a low-priced and easy to use service, while seeking to get many of these same customers to use more advanced services, or to use services more often. Several Platinum subscribers sought to combine advanced logistics capability with near real time mail tracking on an aggregate basis. Still others sought to add proprietary data to Confirm observations to create unique information capabilities of use to direct marketers. (GHS-T-1, p. 6-7)

GHS is unaware of any Confirm reseller whose business model is based on simply paying the fee to become a Platinum subscriber and reselling raw scans to other subscribers in a different category. In practice, GHS has never engaged in this sort of arbitrage, and has no plans to do so in the future.

The USPS witness makes an argument that by charging something for scans rather than retaining the current unlimited option, the opportunity for arbitrage is decreased. But with a pricing structure including an option for unlimited scans, the prospective purchaser has an option to pay the fee to become a Platinum subscriber, which under the OCA proposal is $19,500, and once having done so, has no reason to

purchase scans from any other source. So any opportunity for arbitrage is limited to a maximum gain by a purchaser of $19,500, less what the purchaser would pay to the reseller for the scans. Given this upper bound on the arbitrage opportunity, it seems likely that a business model which does not include competing with other resellers to provide added value would be unsustainable.

To be more specific about the value added services provided by GHS to its customers, they include but are not limited to the following:

1) Detail level record data storage for multiple years, amounting to several terabytes of data
2) Collection and categorization of confidential client data for purposes of combining with scan data to create actionable information
3) Implementation and coordination of client systems to create and monitor production of PLANET and 4-state customer barcodes
4) Purchase of additional subscriber IDs to ensure unique code assignment both within and across clients
5) Custom software programs that assign PLANET and 4-state customer barcodes using statistical models to ensure valid, reliable results
6) Inspection of every single scan to detect data quality problems
7) Results of data quality control sent to USPS, which according to the response to OCA/USPS-T40-26 is done by no other subscriber
8) Custom report development for hard copy, e-mail, and Web distribution, including confidential client data

9) Aggregated delivery reporting depicting results for a particular client versus all others

10) Weekly free electronic newsletter displaying composite delivery data for the prior week

Whatever success GHS may have had in attracting and retaining clients is due to these value added features, and not to any form of arbitrage such as might be available to any subscriber qualifying by volume for lower prices.

What is important to note is that arbitrage has played little or no role in the actual behavior of Confirm subscribers and users, who succeed or fail based on the added value they provide to their customers. GHS does not agree that it is necessary or appropriate to design a Confirm pricing schedule to prevent the possibility of arbitrage, as this would not only disfavor the current pricing schedule, but also any of the proposed schedules.

In addition, as other participants in this rate case may express better than GHS can, it is not necessarily the case that there is anything inherently wrong, or undesirable, about arbitrage. The issue sometimes arises of apparently effortless ("pure") arbitrage being perceived as objectionable. Nonetheless, arbitrage has a function to play in a market to facilitate competition and thereby to lower prices. If pure arbitrage is not to be unduly disparaged, then certainly, value added reselling, such as exemplified in the ten features above, may have definite positive effects.

## IV. POIR NO. 12, QUESTION 6, REQUESTS AN EXPLANATION OF WHY THE USPS CONFIRM PRICING PROPOSAL ASSUMES AN ACROSS THE BOARD TEN PERCENT DECREASE IN CONFIRM SCANS, WHEREAS POTENTIAL SYNERGIES WITH THE 4-STATE CUSTOMER BARCODE AND RELATED ONECODE PRODUCTS ARE OVERLOOKED

GHS has already testified that the OCA proposal, which retains the unlimited option for Confirm scans for Platinum subscribers, is better suited to facilitate growth of the program than the USPS proposal, which has per-scan charges for all subscribers.

Facilitating the growth of Confirm is important for reasons beyond making Confirm revenue cover attributable costs plus a reasonable markup. As GHS has testified, Confirm is also important for fostering the growth of intelligent mail and maintaining the availability of Confirm as an essential element in a robust service performance measurement system for all mail classes.

Providing that the OCA Confirm pricing proposal is adopted and the projected decrease in Confirm scans under the USPS proposal is averted, the introduction of the 4-state customer barcode on September 1, 2006, with services including OneCode Confirm and OneCode Address Change Service (ACS), will enhance the prospects for Confirm revenue and reduce any concern that revenues will fall short of costs,

Based on the experience of GHS and early reports of other subscribers, there is already usage of OneCode Confirm by some customers, and usage of OneCode ACS by others, and there is usage of both services together. This helps to reinforce the point made by GHS in its prior testimony that the OneCode products will attract new customers and potential new subscribers:

> The OneCode ACS program in particular can be expected to have a synergistic effect on Confirm. By developing the capability to use OneCode ACS, which requires use of the four-state code, a mailer is also removing a barrier to the use of Confirm, namely the need to put two barcodes, POSTNET and PLANET, on

> the mail piece. It is reasonable that mailers seeking to use OneCode ACS may also elect to use OneCode Confirm. (GHS-T-1, p. 15-16)

Although the USPS did ask GHS about the potential impact of the introduction of the OneCode products on the market for Confirm (USPS/GHS-T1-9), to which we responded that some positive effects could be expected, the USPS has yet to acknowledge that any additional revenue for Confirm may be derived directly or indirectly from these new products.

There is another potential synergistic effect that could occur if the USPS were to allow 4-state customer barcodes to be used in place of POSTNET codes, even for mailers who are not using any OneCode products. The USPS is expected to allow this once there has been sufficient experience gained with a limited portfolio. At that point, reaching the plateau of using 4-state customer barcodes to replace current functionality will also serve as a platform for ventures into OneCode products, and some of this will gradually turn out to be synergistic for OneCode Confirm.

## V. THE RESPONSE OF THE USPS TO POIR NO. 12, QUESTION 7, UNDERSTATES THE ADVERSE EFFECT THAT HIGHER FEES FOR CONFIRM SCANS IN MAIL CLASSES OTHER THAN FIRST-CLASS WOULD HAVE ON CONFIRM USAGE

The USPS witness concedes that the higher fees for other classes might have an effect on the use of Confirm, but argues that it would not greatly affect the revenue that would be generated. This is not consistent with the USPS position in 2002, which was that Confirm is highly price elastic. Compared with the unlimited option, charging one unit for each First-Class scan will already reduce demand, and charging five units for each scan in other classes will further reduce demand. Many of our customers and other large mailers have told us that the OCA proposal is preferred by them over the

USPS proposal with its per-scan charges that arbitrarily discriminate by mail class. Some of them will be in a position to express their views when briefs are filed. All these difficulties can be avoided with the retention of the current unlimited option pricing structure, through the OCA pricing proposal or some similar approach.

The USPS is concerned that the OCA pricing proposal may not provide for a full recovery of costs, even though the shortfall is only 15%, according to the calculations provided by the USPS itself:

> The current subscription-based fee schedule, even with rates unchanged, comes fairly close to covering the expected costs for the 2008 test year. The total costs when the 1% contingency is included are $1,200,890, according to USPS-T-40, p. 19, but the revenues expected on the basis of the current rates are $1,018,250, based on USPS-LR-L-124_Final.xls, WP-4. In other words, the shortfall is only $182, 640, or 15% of the costs, compared to the breakeven point, although this would have to be increased to take into account the need to make a contribution to the institutional costs. (GHS-T-1, p. 3).

Further, the USPS has yet to acknowledge the testimony of GHS that additional IDs will continue to be purchased, for reasons such as differentiating customers from each other for quality control purposes, even though this is not included in the OCA proposal and its revenue projections. The additional revenue from the purchase of additional IDs serves as a margin of safety to help ensure that the OCA proposal will cover USPS costs.

The Commission should include the revenue from additional IDs that GHS and some other subscribers will purchase in any analysis it may make of the revenues expected to be obtained under the OCA proposal. This revenue is included in the GHS projections in its response to the USPS interrogatories 4 and 15 to USPS/GHS-T1. Should these amounts be overlooked, the revenues to be expected under the OCA proposal will be underestimated.