

USPS-RT-13

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

POSTAL RATE AND FEE CHANGES, 2006

Docket No. R2006-1

REBUTTAL TESTIMONY
OF
DREW MITCHUM
ON BEHALF OF THE
UNITED STATES POSTAL SERVICE

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1 **AUTOBIOGRAPHICAL SKETCH**

2

3 My name is Drew A. Mitchum. I am currently an economist in the office of
4 Pricing at the United States Postal Service. Prior to joining the Postal Service in
5 July, 2004, I was employed by the National Association of Home Builders
6 (NAHB), starting in 2002. At NAHB, I was the Manager, Economics and
7 Statistical Research. My responsibilities there included providing research
8 support to senior staff, researching and writing articles, and maintaining the
9 national, regional, and state forecasts. From 2001 to 2002, I worked at the
10 NASDAQ Stock Market as a Market Data Specialist. My responsibilities were
11 generally related to product management, but also included ensuring the integrity
12 of the data that were disseminated, and writing technical documents. From
13 2000 to 2001, I worked in the Economic Research department of the National
14 Association of Securities Dealers and the NASDAQ Stock Market. From 1997 to
15 1999 I was an associate in the Research department at Watson Wyatt Worldwide
16 (WWW). My work at WWW related to research on defined contribution pension
17 plans. I began my professional career as a Labor Economist at the Bureau of
18 Labor Statistics in the Office of Employment Projection, from 1994 to 1997.

19 I received a Master of Arts degree in Economics from Georgia State
20 University in 1993, and a Bachelor of Science degree in Managerial Economics
21 from Lynchburg College in Virginia in 1991.

22 This is the second time I am testifying before the Postal Rate Commission,
23 as I also offered testimony designated as USPS-T-40 in this proceeding.

1 I. Purpose

2 The purpose of this testimony is to respond to the testimonies of OCA witness
3 Callow (OCA-T-5), GrayHair Software witness Bellamy (GHS-T-1), and Major
4 Mailers Association witness Bentley (MMA-T-1), concerning proposals for pricing
5 Confirm service. My testimony explains why the Postal Service deemed it
6 necessary to propose a new fee structure, why the OCA proposal is inadequate,
7 and how the Postal Service proposal addresses each of the challenges that
8 identified the need for a new pricing structure. I also respond to some specific
9 criticisms and comments by the participants.

10 II. The Issues and How the Proposals Address Them

11 Two participants in this case believe that it was unnecessary for the Postal
12 Service to propose a new fee structure.¹ Moreover, OCA witness Callow
13 expressly proposes retention of the existing fee structure.² The Postal Service
14 disagrees, having concluded that 1) experience with the existing approach to
15 pricing Confirm service demonstrates its shortcomings; 2) even under the OCA's
16 proposed modifications, revenue is unlikely to exceed costs; and 3) pricing for
17 Confirm service needs to accommodate possible future developments while
18 covering costs and making a contribution to institutional costs.

19 The decision to propose a new fee structure for Confirm service was not
20 made lightly. Analysis of how best to price Confirm service began with its failure
21 to cover costs. Then, after evaluating the existing fee structure to identify why

¹ See the testimony of witness Callow (OCA-T-5 at 4), and the testimony of witness Bellamy (GHS-T-1 at 2).

² OCA-T-5 at 14-21.

1 the product was not covering its costs, I identified other shortcomings in the
2 existing fee structure that could be addressed; this resulted in a list of 7 issues
3 that guided the development of a new fee structure. The seven issues are:

- 4 (1) the current fees do not generate revenue sufficient to cover costs;
 - 5 (2) fee increases sufficient to generate a moderate cost coverage must
6 compensate for the reduced usage that results;
 - 7 (3) higher fees would increase the potential size of arbitrage opportunities;
 - 8 (4) within each tier in the existing fee structure, higher scan volume users
9 benefit more than lower volume users;
 - 10 (5) choosing the optimal tier can be difficult for new subscribers;
 - 11 (6) availability of unlimited scans actually benefits few subscribers; and
 - 12 (7) the structure does not facilitate the introduction of other information-based
13 services.
- 14

15 A. Covering Costs

16 The failure of Confirm to cover its costs was one of the primary concerns
17 regarding the existing fee schedule. In preparing Docket No. R2005-1, the
18 Postal Service determined that issues involving maturation of the product, costs
19 and revenues were of sufficient import to leave Confirm service out of the case.³
20 In preparation for filing Docket No. R2006-1 (and to some extent in preparation
21 for filing Docket No. R2005-1) substantial analysis was undertaken to determine
22 how best to obtain the necessary revenue. My analysis began with evaluating
23 the existing pricing structure. A fee increase could encourage mailers to begin
24 seeding to keep their overall fees low, and fee increases would need to be
25 distributed such that no entity would benefit excessively or be harmed
26 excessively. Most importantly, the fee increases, given their magnitude, needed
27 to be structured to account for the potential that they would reduce demand. The

³ See Notice Of The United States Postal Service Regarding Exclusion of Confirm Service from General Rate Proceeding, filed April 8, 2005.

1 task was to find the least disruptive, yet reasonably effective, way to get the
2 needed revenue while making at least a moderate contribution to the institutional
3 costs of the Postal Service.⁴ Unfortunately, accomplishing this goal while
4 retaining the existing structure is hindered by many considerations, including:

- 5 (1) Fee increases decrease demand, and may cause subscribers to stop
6 using Confirm, or to diminish use;
- 7 (2) Higher fees for Platinum subscribers would encourage migration to the
8 Gold tier;
- 9 (3) Pure arbitrage could greatly reduce the number of direct end user
10 subscribers; and
- 11 (4) Users of disparate sizes face the same fees.

12
13 For these reasons, we concluded that covering costs using the existing fee
14 structure was improbable.

15 1. OCA Proposal - *Covering Costs*

16 The ability of the OCA proposal to cover costs depends on several
17 assumptions about subscriber reaction to the proposed fee increases: (1) no
18 decrease in demand, (2) no migration to a less expensive tier, (3) no subscribers
19 will stop using Confirm, and (4) no impact from arbitrage. The OCA proposal
20 also depends on those subscribers who previously chose the more expensive
21 Platinum tier, even while the Gold tier could have satisfied their demand, to
22 continue doing so despite fee differential increases of 160 percent.⁵

⁴ GrayHair Software witness Bellamy agrees. GHS-T-1 at 3.

⁵ This 160 percent increase in the differential is derived by dividing the differential under the OCA proposal by the differential that exists today and then subtracting 1: $\$14,300 / \$5,500 - 1 = 160\%$.

1 2. Postal Service Proposal - *Covering Costs*

2 No participant asserts that the Postal Service proposal would generate
3 insufficient revenue to cover costs. That is because the proposal affirmatively
4 addresses the weaknesses of the existing fee structure (*see, e.g.,* section II(A),
5 above) , rather than assuming them away. Additionally, unlike witness Bentley's
6 proposal, the Postal Service proposal recognizes and accommodates the need to
7 cover costs.

8 B. Impact on Customer Behavior

9

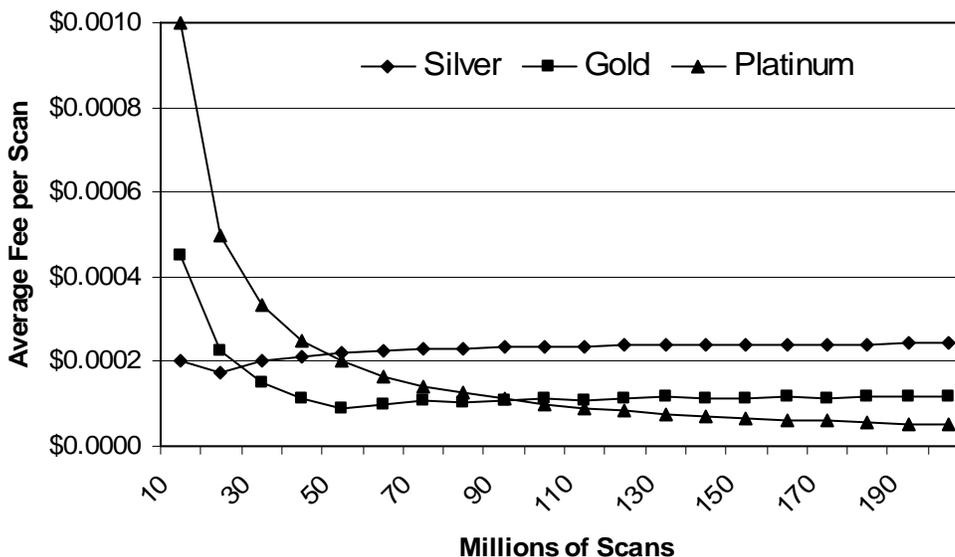
10 With the large revenue increase necessary to cover costs, any fee increase is
11 likely to affect customer use of Confirm service. Confirm service is a necessity
12 only for those subscribers who derive their revenue from the reselling of Confirm
13 scans. Many end user subscribers may well view Confirm service as a
14 discretionary good, which could be cut from the budget during tough times or in
15 the face of large fee increases that are applied recklessly.

16 Aside from stopping use of Confirm altogether, three responses are readily
17 available: (1) begin seeding, (2) move to a less expensive tier, and (3) take
18 business to a reseller.

19 Each tier allows for any number of scans, but for any specific number of
20 scans only one tier provides the lowest cost per scan (*see* Figure 1, below).
21 Note that the average fee per scan for both Silver and Gold subscribers starts
22 increasing shortly after acquisition of additional scans (while the average fee per
23 scan for Platinum subscribers declines continuously). Also note that the Gold

1 subscription is the least expensive option until a subscriber uses more than 92
 2 million scans.

3 **Figure 1: Average Fee per Scan for Scan Volumes from 10 to 200 Million**
 4 **by Tier**



5

6 The current fee schedule has resulted in some Confirm subscribers buying
 7 more scans than, in retrospect, they actually used. Some Platinum subscribers,
 8 for example, could have realized a lower net cost per scan with Gold
 9 subscriptions. While customer overpayment has reduced the amount of the
 10 shortfall in Confirm revenues, it would be imprudent to assume its continuation,
 11 especially when faced with substantial fee increases.

12 The chief reason why a subscriber might overpay upon signing up for Confirm
 13 service is the inability to project how many scans will be used over the course of
 14 a year. For \$10,000, a subscriber would be sure to have enough scans. In the
 15 face of a substantial fee increase, and after gaining experience with Confirm

1 service, customers are likely to make more cautious and more accurate
2 projections, thus reducing the number of overpayers.

3 One concern related to the existing fee structure is that the fees paid by the
4 45 Platinum subscribers (25 percent of all subscriptions) account for 44 percent
5 of total revenue in the base year (excluding revenue from Additional IDs). These
6 45 subscribers include many whose use is less than 50 million scans, a level that
7 really warrants only a Gold subscription.

8 As the gap between Gold and Platinum subscription prices increases, so, too,
9 does the threshold (millions of scans) at which a Gold subscription costs less
10 than a Platinum subscription. Table 1, below, illustrates this by holding the Gold
11 subscription price at \$4,500 while increasing the Platinum subscription price from
12 \$10,000 to \$50,000.

13

14 **Table 1. How Increases in the Platinum Fee Make**
15 **the Gold Tier More Attractive**

Platinum Tier Fee (\$)	Gold Tier Fee (\$)	Difference in Fees (\$)	Additional Block Fee	Blocks that could be Purchased	Millions of Scans Below Which Gold Tier is Cheaper
10,000	4,500	5,500	750	7	92
15,000	4,500	10,500	750	14	134
20,000	4,500	15,500	750	20	170
25,000	4,500	20,500	750	27	212
30,000	4,500	25,500	750	34	254
35,000	4,500	30,500	750	40	290
40,000	4,500	35,500	750	47	332
45,000	4,500	40,500	750	54	374
50,000	4,500	45,500	750	60	410

16

1 This exercise illustrates why the existing 45 Platinum subscribers would be
2 increasingly unlikely to remain as Platinum subscribers if there were a large
3 increase in fees. For each Platinum subscriber that chooses to move to a lower
4 tier, the price for the remaining Platinum subscribers would also need to increase
5 even more. Another consequence of increasing the gap between Gold and
6 Platinum subscription prices is an increase in the arbitrage opportunity, a topic
7 discussed separately in section II(C).

8 Finally, the existence of resellers must be considered. Today most resellers
9 add value to the raw Confirm scans a direct subscriber would receive. Resellers
10 accordingly expand the market for Confirm service by assisting firms without the
11 technological expertise or mail volume that might permit them to be direct
12 subscribers. The Postal Service fully supports the existence of the Confirm
13 aftermarket, much as it supports other businesses dependent upon mail,
14 including, for example, firms that provide automation compatibility, presortation,
15 co-mailing, or co-palletization to mailers. Nonetheless, each direct subscriber of
16 Confirm that moves to a reseller under the existing fee structure reduces Confirm
17 revenue while imposing a greater cost burden on the remaining Confirm
18 subscribers.

19 1. The OCA Proposal - *Impact on Customer Behavior*

20 Witness Callow provides no support for his assumption that his proposed fees
21 would not reduce usage of Confirm. Yet he recognizes that the Postal Service
22 proposal assumes a decrease in usage as a result of the fee increase, and

1 apparently agrees that usage will decrease with price increases.⁶ Since both
2 proposals involve significant increases, it is implausible to think that only one of
3 them reduces usage. As such, it is difficult to accept witness Callow's dual
4 claims that the OCA proposal will achieve a cost coverage greater than under the
5 Postal Service proposal without incurring a decrease in demand.

6 Witness Callow does not consider the potential for subscribers to react to fee
7 increases by seeding their mailings with Confirm barcodes or moving to a less
8 expensive tier. For example, under the existing fee schedule a Platinum
9 subscriber getting 51 million scans a year could choose to seed some mailings to
10 reduce usage below the 50 million scan threshold and (1) move from the
11 Platinum to the Gold tier without needing to buy additional scans, or (2) to save
12 \$750 by not buying an additional block of scans. If the price differential between
13 the two tiers were to be widened from \$5,500 to \$14,300, as the OCA proposes,
14 customers are even more likely to seed or move to a lower tier.

15 Witness Callow assumes that those Platinum subscribers who could save as
16 much as \$5,500 by moving to the Gold tier under the existing fees will decide to
17 pay as much as \$14,300 more than is necessary under his proposed fees.⁷
18 Witness Callow offers two justifications for this assumption. First, he assumes a
19 lack of price sensitivity because the Postal Service has not explained why some
20 subscribers overpay by \$5,500 today. Second, after confirming that 29 Platinum
21 subscribers could save at least \$12,800 by switching to a Gold subscription he

⁶ OCA-T-5 at 7.

⁷ Response to USPS/OCA-T5-2, Tr. 21/7791-93.

1 says that “such a decision on the part of the 29 subscribers is not assured.”⁸
2 Trusting that subscribers will choose to spend substantially more than necessary,
3 he concludes “that there would be little or no effect on the number of Platinum
4 subscribers.”⁹

5 Assuming that current overpayers will continue to overpay when faced with
6 the OCA’s proposed prices, and the much bigger gap between Gold and
7 Platinum, is unreasonable. At least seven of the existing subscribers must
8 continue to overpay (by much more than today) for the OCA proposal to result in
9 a cost coverage of greater than 100 percent.¹⁰ This is an odd revelation given
10 that one of the reasons that OCA considers its proposal superior is that it is
11 intended to produce a slightly higher cost coverage than the Postal Service
12 proposal.¹¹

13 To quantify the sensitivity of the overpay assumption made by witness
14 Callow, I assume that Confirm subscribers choose to pay as little as possible,
15 and choose the Gold tier when it is less expensive. When the 29 Platinum
16 subscribers that could save money move to the Gold tier, the fee for Platinum
17 subscribers would have to be raised to a value in excess of \$42,500¹² if the fees

⁸ Response to USPS/OCA-T5-2, Tr. 21/7791-63.

⁹ Response to USPS/OCA-T5-2, Tr. 21/7791-93.

¹⁰ Response to USPS/OCA-T5-3, Tr. 21/7794.

¹¹ See the testimony of witness Callow (OCA-T-5 at 19, 25).

¹² Actually, witness Callow has calculated this figure as an even higher \$45,400 (USPS/OCA-T5 at 3, Tr. 21/7794 and 20, Tr. 21/7821-22). He failed to consider that some of the subscribers making the move to the lower tier would need to buy additional blocks of scans at \$750 each, which lowers the required fee for the Platinum subscription to about \$42,500.

1 for the Silver and Gold tiers were to remain at the level proposed by the OCA.¹³
2 Witness Callow did not appear to recognize that if the Platinum fee increased to
3 this level, still more subscribers would save money by moving to the Gold tier,
4 thus requiring the fee for a Platinum subscription to be even higher. This spiral
5 effect must be considered when trying to assure any level of contribution from
6 Confirm service.

7 Additionally, if any Gold and Platinum subscribers stopped subscribing due to
8 the price increases, the fees for Platinum subscribers would have to increase
9 even more. Finally, given that Gold subscribers can upgrade their subscriptions
10 to Platinum by paying the difference in fees between the two tiers at any time,
11 customers should feel comfortable switching to the Gold tier, even if early
12 projections of scan usage appear to justify a Platinum subscription.

13 The OCA proposal also appears to ignore that resellers are an alternative
14 source for Confirm service. As the fees increase under the existing structure the
15 potential for pure arbitrage reselling increases, and some users will likely take
16 advantage of the opportunity to reduce their Confirm expenditures by having their
17 scans routed through a reseller. The problems surrounding arbitrage are
18 discussed in section II(C), below.

19 2. Postal Service Proposal - *Impact on Customer Behavior*

20 The Postal Service proposal fully recognizes that a significant increase in fees
21 will result in a decrease in demand. Thus, I conservatively assume that

¹³ I chose to hold the fee levels for the Silver and Gold tiers at those proposed by the OCA, as does witness Callow in his response to USPS/OCA-T5-20, by creating a table whose cost coverage calculations are based exclusively upon changes in subscription fees.

1 increasing fees will reduce demand by ten percent; I elaborate upon my
2 reasoning behind this assumption in my response to POIR 4, question 3.

3 I did not find it necessary to explain why some current subscribers overpay,
4 because the Postal Service proposal does not depend on subscribers choosing
5 to overpay to generate the projected revenue. I considered customer
6 overpayment – and the likelihood that it may not continue – as a reason for
7 concern that contributed to my decision to develop a new fee structure.

8 The Postal Service proposal does not prevent mailers from seeding; on the
9 contrary the Postal Service assumes that some mailers will begin seeding to
10 reduce their costs. My assumption that the overall number of scans used will
11 decrease by 10 percent accommodates the expected seeding.

12 Movement to resellers is accepted as a likely reality in the future under the
13 Postal Service proposal. The impact of this movement is limited by the
14 introduction of per scan fees. This will be discussed in detail in the arbitrage
15 section.

16 C. Reseller Arbitrage Opportunity

17 Arbitrage is the process by which someone purchases a commodity and then
18 resells the commodity so as to profit from a pricing discrepancy. In the case of
19 Confirm service, a reseller takes advantage of the availability of unlimited scans
20 for a fixed price by acting as a middle man for several subscribers, offering each
21 of them a savings over what they would pay the Postal Service to subscribe
22 directly to the service. The reseller profits by collecting more money from his
23 customers than he pays for the unlimited scans.

1 The current pricing structure promotes arbitrage because the Platinum
2 subscription provides unlimited scans.¹⁴ The Postal Service was aware of this
3 potential before implementing Confirm service (see the testimony of witness
4 Rothschild, USPS-T-4, PRC Docket No. MC2002-1) and continues to support
5 this market sector. For two reasons, arbitrage is not currently a major problem
6 for Confirm service:

7 (1) the fee for Confirm is relatively low, requiring a fairly large number of
8 customers to make reselling profitable; and

9 (2) adding value to the raw scans can be more lucrative than simply reselling
10 raw data.

11
12 Confirm service provides raw scan data, which require aggregation,
13 manipulation, or analysis to be useful. The Postal Service recognizes that many
14 resellers are providing these value added services to their customers, and that
15 resellers increase usage of Confirm. However, resellers have greatly benefited
16 from their ability to attract potential Postal Service customers and redirect their
17 payments away from the Postal Service. While the fact that resellers earn a
18 profit is not a problem, the failure of Confirm service to cover costs is not
19 permitted.

20 Maintaining the existing fee structure while trying to increase revenue by
21 nearly 50 percent so the product has a moderate cost coverage would increase
22 the opportunity for pure arbitrage reselling. Higher prices for Confirm service
23 mean that a pure arbitrage reseller can charge more for raw scans routed
24 through them. Thus, fewer customers are needed to make reselling, without
25 adding value, feasible. Rather than paying 95 percent more than customers do

¹⁴ See my response to Presiding Officer's Information Request No. 12, Question 5.

1 today, as they would under the OCA proposal, a direct subscriber might well
 2 choose to save money by having their scans routed through a reseller. Under the
 3 existing fee structure, each customer that moves to a reseller results in the
 4 Postal Service losing the Confirm service revenue for that customer, which in
 5 turn requires a larger overall fee increase to offset the lost revenue.¹⁵ Once pure
 6 arbitrage resellers enter the picture a troubling cycle begins:

- 7 (1) Increased fees make arbitrage resellers feasible;
- 8 (2) Direct end users choose resellers to save money;
- 9 (3) Fees need to be raised to offset revenue lost from customers
 10 switching to resellers;
- 11 (4) Higher fees make resellers even more attractive, causing more
 12 users to choose resellers;
- 13 (5) Steps (3) and (4) repeat until almost all customers are resellers,
 14 with the fees prohibitively high for any new direct subscribers.
 15

16 1. The OCA Proposal - *Reseller Arbitrage Opportunity*

17 The OCA did not consider arbitrage, which was one of the concerns that led
 18 to the Postal Service proposal. Witness Callow not only admits that it was not
 19 considered during the development of his proposal, but he also admits that he
 20 had not reviewed POIR No.12, question 5, which was filed 2 weeks before his
 21 testimony.¹⁶

22 Pure arbitrage reselling¹⁷ is a more pressing concern under the OCA proposal
 23 than under the Postal Service proposal. As noted above the higher the fees
 24 subscribers face the more attractive resellers become. As the OCA proposal

¹⁵ If the number of subscribers decreases then the fee increase must be higher; for example, if you have a revenue target of \$100 and 10 customers, the fee per customer is \$10. However if 2 of those customers stop buying the product, the fee needs to be \$12.50 for the remaining 8 customers to get \$100 in revenue.

¹⁶ Tr. 21/7839.

¹⁷ That is, the data are provided in raw format, with no analysis or value added by the reseller.

1 utilizes the existing fee structure, each subscriber lost to a reseller results in the
2 Postal Service losing all of the revenue for that customer. Thus the loss of a
3 Platinum subscriber under the OCA proposal would reduce the revenue for the
4 Postal Service by \$19,500, or 1.3 percent of total projected revenue. Of course,
5 the loss of revenue would require larger fee increases for the remaining
6 subscribers to generate the requisite revenue, further encouraging use of
7 resellers.

8 2. Postal Service Proposal - *Reseller Arbitrage Opportunity*

9 Under the OCA proposal the Postal Service loses all the revenue from a
10 Confirm subscriber who switches to a reseller. However, under the Postal
11 Service proposal, the reseller must purchase additional scans for each new
12 customer, so the Postal Service does not lose all of that customer's revenue. In
13 witness Callow's response to USPS/OCA-T5-24, he confirms that under the OCA
14 proposal the loss of a subscriber using 200 million scans to a reseller would
15 reduce revenue by \$19,500; under the Postal Service proposal the lost revenue
16 would be at most \$7,030.¹⁸

17 D. Fairness and Equity

18 The wide range in the number of scans used by customers within a tier
19 complicates the pricing of Confirm service. With the unlimited option, grossly
20 different costs per scan can exist between customers in the same tier. But even

¹⁸ Under the Postal Service proposal the subscriber would have been paying \$16,380 for their scans, and the reseller would have to expend \$9,800 for 560 additional blocks of scans, this assumes that the reseller is buying blocks at the \$17.50 rate.

1 for the other tiers, a Confirm subscriber who uses a small number of scans pays
 2 much more per scan than does a user of a large number of scans. This pricing
 3 approach definitely favors high-volume subscribers, a consequence that is
 4 unduly exacerbated by the fee increases proposed by the OCA. See Table 2.

5 **Table 2. Average Price per Million Scans for Platinum Subscribers**
 6 **Under Existing Fees, and the OCA and Postal Service Proposals.**
 7

Scans Used	Average Price per Million Scans ¹⁹		
	Existing Fees	OCA Proposal	USPS Proposal
51,000,000	\$196.08	\$382.35	\$186.91
164,000,000	60.98	118.90	91.95
1,000,000,000	10.00	19.50	56.03
10,000,000,000	1.00	1.95	49.70

8
 9 Table 2 shows how the Postal Service proposal retains more revenue from very
 10 high volume Confirm customers than does the OCA proposal. Note that no
 11 customers have yet used as many as 1 billion scans in a year, so the top two
 12 rows are more representative of the situation today.

13 1. The OCA Proposal - *Fairness and Equity*

14 The fee increase proposed by the OCA significantly reduces fairness and
 15 equity. It appears the OCA has ignored the disparate treatment afforded small
 16 and large users under the existing structure, as its proposal exacerbates current
 17 differences.

¹⁹ Witness Callow confirms that, in his response to interrogatory USPS/OCA-T5-15 (Tr. 21/7809-11), the numbers presented in columns 3 and 4 are accurate representations of the average price per million scans subscribers would face under his proposal and the Postal Service proposal. The second column is then derived by dividing \$10,000 by the number of millions of scans presented in the first column, example (e.g., \$10,000 / 51 = \$196.08).

1 Under the OCA proposal, the fee per scan disparity between the largest and
2 smallest users can be very large. In response to interrogatory USPS/OCA-T5-15,
3 witness Callow confirms that a Platinum subscriber using 51 million scans pays
4 19.8 times more per scan than a subscriber using 1 billion scans, and 198 times
5 more than a subscriber using 10 billion scans. His justification for continuing this
6 disparity is that it is an incentive for subscribers to place Planet Codes on all of
7 their mail.²⁰ But no incentive would help a small subscriber who is already
8 placing Planet Codes on all of her mailpieces. The result for these smaller
9 mailers is that they pay substantially higher fees per scan.

10 2. Postal Service Proposal - *Fairness and Equity*

11 One benefit of the Postal Service proposal is that all customers face a single
12 fee schedule, with all customers who use the same number of scans incurring
13 the same fee for those scans. Table 2 shows that a subscriber using 51 million
14 scans only pays 4 times as much per million scans as the subscriber using 10
15 billion scans, whereas under the OCA proposal a 51 million scan customer pays
16 198 times as much as the ten billion scan customer. Thus the Postal Service
17 unit-based fee proposal clearly offers improvement with regard to both fairness
18 and equity. In particular, the average fee for the Platinum subscriber using 51
19 million scans will actually decrease relative to the existing fees. This lower fee
20 for smaller users better encourages use than does the OCA proposal, which
21 almost doubles the cost to these users.

²⁰ See the response to USPS/OCA-T5-15(d), Tr. 21/7809-11.

1 E. Simplicity

2 The existing fee structure can apparently encourage a new subscriber to
3 over-project its expected use of Confirm service. Potential subscribers uncertain
4 about how many scans they will use apparently choose to purchase a Platinum
5 subscription even when, in retrospect, a Gold subscription would have sufficed.

6 1. The OCA Proposal - *Simplicity*

7 The OCA retains the existing structure and the complexity of 3 different sets
8 of subscription prices: it appears likely that retention of that structure will
9 continue depressing the number of subscribers. The large fee increase
10 proposed for Platinum subscribers will likely reduce the number of subscribers
11 that choose to start with the Platinum subscription.

12 2. Postal Service Proposal - *Simplicity*

13 The Postal Service proposal places all subscribers on a level playing field, as
14 all subscribers pay the same amount for the same number of units. This is
15 simpler than the existing structure, under which customers can obtain any
16 number of scans under any of the three tiers, but the cost per scan differs greatly
17 from one tier to the next. The simplicity of the Postal Service proposal also
18 eliminates the possibility of overpaying.

19 F. Value of Unlimited Scans

20 The availability of unlimited scans provides value to only to a few subscribers.
21 As noted by witness Bentley, "a gold subscriber could purchase 98 million First-
22 Class scans for \$10,500." Therefore, all but the 23 current subscribers using

1 more than 92 million scans would save money under the current fees by
2 selecting a Gold subscription (\$4,500) and buying up to 7 additional blocks of 6
3 million scans ($\$5,250 = \750×7). Thus under the current fee structure only
4 those mailers using more than 92 million scans benefit financially from the
5 availability of unlimited scans.

6 Additionally, the number of potential direct end user subscribers that can
7 benefit from unlimited scans is limited. Witness Bentley's testimony provides a
8 First-Class Mail example of this when he notes that the 100 most active First-
9 Class Mail permits account for 42 percent of all presorted First-Class Mail in
10 2005.²¹ In 2005, there were 42,452 presort First-Class Mail permits. Thus the
11 remaining 42,352 of those permits account for the other 58 percent of presort
12 First-Class Mail, and average only 658,926 pieces per permit, far less than the
13 number of pieces which would justify a Platinum subscription.²² Customers using
14 Planet Codes on fewer than 69 million pieces would pay less using the Gold tier,
15 so the availability of unlimited scans at the Platinum tier for those customers is
16 not beneficial.²³ Thus, very few First-Class Mail mailers would be able to benefit
17 from the availability of unlimited scans if they were to become subscribers.

²¹ See Appendix 1, footnote 2, of witness Bentley's testimony, and the response to MMA/USPS-5, Tr. 14/3924.

²² The number of Permits were reported in USPS-LR-L-124. The average number of pieces was derived from the information provided in response to MMA/USPS-5. $658,926 = 20,208,386,457 / 0.42 \times 0.58 / 42,352$.

²³ The point where the Platinum tier is more cost effective than a Gold tier subscription is 164 million scans; see response to USPS/OCA-T5-2(d), Tr. 21/7791-93. Assuming 2.3638 scans per mail piece (see the response to USPS/OCA-T5-5, Tr. 21/7796-97), 164 million scans are sufficient to track 69,379,812 mailpieces.

1 1. The OCA Proposal - *Value of Unlimited Scans*

2 As noted above, unlimited scans ultimately benefit only those for whom a
3 Gold subscription, with the purchase of additional scans, costs more than a
4 Platinum subscription. Under the OCA proposal, a subscriber must use more
5 than 164 million scans for a Platinum subscription to make economic sense.
6 Only 15 subscribers (8.3 percent of subscribers) currently use that many scans.

7 Under the OCA proposal, and assuming no change in Confirm volume by
8 existing customers, only 15 subscribers will find the OCA's Platinum tier their
9 least expensive option. Thus less than 10 percent of subscribers would benefit
10 from the availability of unlimited scans.

11 2. Postal Service Proposal - *Value of Unlimited Scans*

12 The Postal Service proposal eliminates the availability of unlimited scans,
13 thus protecting the revenue stream from arbitrage. As discussed above, the
14 movement to a per scan fee allows the Postal Service to limit the revenue lost
15 when resellers successfully recruit existing direct subscribers. Rather than losing
16 the full revenue stream, as would be the case under the OCA proposal, the
17 Postal Service still retains some revenue.

18 G. Compatibility with Future Enhancements

19 The Postal Service is pursuing other activities that might provide information-
20 based services, such as container scans to improve mail processing, and
21 recognizes that these potential services could have value to mailers. A method
22 for distributing the information generated by those scans will be necessary. One

1 method for disseminating that information is the Confirm infrastructure. But the
2 current Confirm fee structure does not offer the flexibility to differentiate among
3 the various types of information and the relative cost of gathering and distributing
4 that data.

5 1. The OCA Proposal - *Compatibility with Future Enhancements*

6 The OCA proposal's design fails to consider any accommodation in Confirm
7 service to pricing other uses of scans, including the possible use of the Confirm
8 infrastructure to facilitate the dissemination of information originating from
9 sources other than passive scans. In response to USPS/OCA-T5-16 witness
10 Callow states:

11 My proposal does not address the potential introduction of manual
12 scans of containers into Confirm service. I gave no consideration
13 to this possibility.

14
15 This omission by the OCA in developing its own proposal for pricing Confirm
16 service exemplifies how failure to consider the context in which products and
17 services exist can lead to short sighted proposals. The Postal Service proposal
18 instead recognizes the dynamic environment in which pricing decisions must be
19 made.

20 2. Postal Service Proposal - *Compatibility with Future Enhancements*

21 One reason that the Postal Service decided to base fees on units rather than
22 scans was to accommodate the possibility of using Confirm to disseminate
23 information about, for example, container scans. Units would allow that Postal

1 Service to charge a different fee for container scans than for mailpiece scans to
2 the extent the generation and provision of such data is more costly.

3 **III. Participant Testimony and Responses to Written Cross-Examination**

4 The testimony of the three intervenors raised various issues that merit
5 comment. The previous sections touch on these issues, and this section
6 summarizes the specific limitations of the intervenors' testimony. Each
7 intervenor's comments are addressed separately.

8 **A. GrayHair Software Witness Bellamy**

9 GrayHair Software is a large reseller of Confirm service, and its witness,
10 Cameron Bellamy, focuses on how the OCA and Postal Service proposals would
11 affect his firm's ability to profitably use the Confirm service. His testimony
12 includes many assertions which are poorly explained or substantiated. Using
13 discovery, the Postal Service attempted to improve its understanding of how our
14 proposal would impact GrayHair Software's ability to continue a profitable use of
15 Confirm service. Unfortunately, his evasive responses to those interrogatories
16 shed little light on the subject, and merely criticized the Postal Service proposal.

17 One argument made in witness Bellamy's testimony is that Confirm service
18 should use an Internet pricing model with an unlimited option. In response to the
19 Postal Service's request for the basis of his perceived requirement, he compares
20 Confirm service to Google. He notes that Google wisely chooses not to charge
21 for each search a customer submits. He fails to recognize that Google's
22 business model is based on generating revenue via advertising. Trying to charge

1 for each search submitted when other search engines exist that offer searches
2 for free would have reduced user visits to the site, thereby decreasing the
3 amount Google could charge for advertising. However, since Confirm service
4 does not generate its revenue from advertising, Google cannot reasonably be
5 compared to Confirm service.²⁴

6 Much of witness Bellamy's concerns about the Postal Service proposal simply
7 echo the fact that GrayHair Software would no longer receive the benefit of
8 unlimited scans. His claims are that the existing fee schedule is superior, while
9 he fails to consider or address its failure to cover costs each year that the service
10 has been offered. The Postal Service proposal will result in large customers
11 paying more for Confirm service than under the existing structure, but it should
12 place Confirm service on a sound financial footing, thus allowing the Postal
13 Service to continue making it available, and thereby benefiting GrayHair
14 Software.

15 **B. Witness Bentley**

16 MMA witness Bentley notes that the unit contribution First-Class Mail makes
17 to institutional costs is more than twice that of Standard Mail. This, he asserts,
18 justifies charging less for First-Class Mail than for other classes.²⁵ As such,
19 witness Bentley implicitly supports the Postal Service proposal to charge fewer

²⁴ While Confirm service could become more like Google by charging resellers based on how many customers they obtain, the record is bereft of explanations as to why this should be. The Postal Service is not planning on imposing a special fee on resellers, even though, arguably, such a fee could be likened to an advertising charge, since the existence of Confirm service is the basis for each reseller's ability to attract customers.

²⁵ See the response to USPS/MMA-T1-22, Tr. 21/7900-01.

1 units per First-Class Mail Confirm scan than for each Standard Mail scan. The
 2 Postal Service agrees that First-Class Mail's higher value of service is consistent
 3 with the inclusion of various ancillary services at no additional charge.²⁶

4 Witness Bentley's recommendation that Confirm be rolled into the price of
 5 First-Class Mail or that First-Class Mail users only pay \$2,000 for unlimited
 6 usage, is not a complete proposal for Confirm service. It fails to address many
 7 necessary issues, such as:

- 8 • Whether such a subscription would provide any information about
 9 Standard Mail pieces to the extent a mailer sends both First-Class Mail
 10 and Standard. Would a separate subscription be necessary for
 11 Standard Mail?
- 12 • Should a portion of Confirm costs be allocated to First-Class Mail, and
 13 if so, how much?

14
 15 Under the Postal Service proposal, a customer could obtain 1 billion First-
 16 Class Mail scans for only \$24,530.²⁷ That is enough scans to monitor 1 percent
 17 of all presort First-Class Mail (423 million pieces), at a cost of only 0.006 cents
 18 per mailpiece. The ability to track the progress of a mailpiece for only 0.006
 19 cents appears to be quite a bargain.²⁸ Moreover, Confirm fees would be less
 20 than 0.02 percent²⁹ of the postage for 423 million First-Class Mail 5-digit
 21 automation presort letters (\$132 million).³⁰

22 Nevertheless, witness Bentley offers an intriguing notion of providing scans
 23 for First-Class Mail at zero units each. While this would still have some of the
 24 problems associated with an unlimited scan option, limiting the "zero unit" pricing

²⁶ See the response to OCA/USPS-T40-31(d), Tr. 14/3959-60.

²⁷ See the table presented in the response to USPS/GHS-T5-16, Tr. 21-7496.

²⁸ $\$24,530/423,047,635 = \0.0000580

²⁹ $\$0.0000580/\$0.312 = .01858\%$

³⁰ This represents the per-piece proposed postage of \$0.312, which is the lowest rate available to presort First-Class Mail users.

1 to First-Class Mail would limit those concerns, and be consistent with the notion
2 that First-Class Mail is a premium product.

3 C. OCA and Witness Callow

4 The Office of the Consumer Advocate has been a leading critic of the Postal
5 Service proposal for the commercial product called Confirm. OCA criticism often
6 lacks supporting explanation, or is based on incorrect calculations.

7 Witness Callow claims that the loss of the unlimited scan option would greatly
8 hamper Confirm subscribers. However a maximum of 15 Platinum subscribers
9 would benefit from unlimited scans under his proposal, and the benefit they gain
10 is at the expense of the smaller users that cannot benefit from unlimited scans.³¹

11 Under the Postal Service proposal a subscriber would need to use in excess of
12 712 million units (254 million scans) to have a total fees exceeding \$19,500.³²

13 Only 12 Platinum subscribers use more than 254 million scans, so 3 of the
14 remaining 15 Platinum subscribers would pay less under the Postal Service
15 proposal than under the OCA proposal. Additionally, all of the Platinum
16 subscribers who buy down to the Gold tier and use more than 110 million scans
17 would pay less under the Postal Service proposal.³³

18 Additionally, the cross-examination conducted by counsel for the OCA was
19 concentrated on resellers and their ability to receive as many as 10 billion scans

³¹ Only 15 subscribers use more than 164 million scans, which is the number of scans a Gold subscriber can acquire for less than the OCA's proposed price for the Platinum tier of \$19,500.

³² See the response to USPS/OCA-T5-10, Tr. 21/7803.

³³ A Gold subscriber using 110 million scans under the OCA proposal would pay \$12,700 (\$5,200 fee plus \$7,500 for 10 additional blocks of scans). Under the Postal Service proposal the same subscriber would pay \$12,420 (\$5,000 for the annual fee and \$7,420 for 307 additional blocks of units.

1 per year for a very low fee.³⁴ Of course, any successful limitation of the price
2 increase for these large resellers can only mean larger increases to other
3 Confirm subscribers. Some of those other subscribers would have to pay the
4 same amount as the resellers that OCA, by virtue of its proposal, seems most
5 concerned about. And despite paying the same amount as the largest resellers,
6 these other subscribers would be obtaining only a small fraction of the scan
7 information that the larger subscribers receive.

8 **IV. Conclusion**

9 The Postal Service proposal is based on thorough analysis of the
10 shortcomings of the existing fee schedule. I was tasked with developing a plan
11 to allow Confirm to cover its costs, while also improving the product. I concluded
12 that the best way to do so was to create a pricing structure that would not only
13 cover costs, but also improve fairness and equity, prepare the product for future
14 enhancements regarding the dissemination of other information, and protect the
15 revenue stream from some of the effects of arbitrage. The Postal Service
16 accordingly stands by its proposals for Confirm service in this docket.

³⁴ Tr. 14/4159.