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**REPLY BRIEF OF GRAYHAIR SOFTWARE
ON PRICING OF CONFIRM SERVICE**

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REPLY BRIEF OF GRAYHAIR SOFTWARE ON PRICING OF CONFIRM SERVICE

NO INTERVENOR OTHER THAN THE USPS FAVORS THE USPS CONFIRM PRICING PROPOSAL OVER THE OCA CONFIRM PRICING PROPOSAL

Of all those submitting initial briefs on Confirm pricing, or commenting on the issue, none outside the Postal Service recommended the USPS proposal. Most of those who took a position favored the OCA position, but even for those who favored the MMA position, all made clear that they favored the OCA pricing over the USPS proposal. Several of the participants questioned the need for an increase for Confirm of the overall magnitude of 49% proposed by USPS, and all of them disagreed with the new rate structure proposed for Confirm. Since the USPS has now effectively withdrawn its collateral proposal (USPS Initial Brief, p. 286) to weaken the link between Confirm and service performance measurement in the DMCS (that it originally put forward in 2002), the 2006 pricing proposal that would further weaken Confirm should now also be sent to the reject bin.

THE USPS PRICING PROPOSAL FOR CONFIRM IS NOT ANALOGOUS TO ITS PRICING PROPOSAL FOR ADDRESS CORRECTIONS

In its initial brief, the USPS draws a comparison between its Confirm pricing proposal and its proposal for pricing address corrections, in that both make differentiations in pricing by mail class. Though neither of these proposals has been approved by the Commission, GHS would like to note that there are other relevant differences between the two cases.

The USPS proposes price differences for different forms of address correction, including differences based on the higher costs of manual corrections versus electronic and automated corrections, differences in First-Class versus other classes, and differences for the first two notices in automated correction versus subsequent notices.

The key difference between the address correction situation and Confirm is that there are cost differences involved in address correction, predominantly because of the relative mix of letters and flats in the various mail classes, whereas Confirm scan costs do not vary by mail class.

The Postal Service intentionally charges no fee for the first two automated address corrections in First-Class, which is several tenths of a cent below the attributable cost to the USPS of providing the corrections. Apparently, the USPS realizes that it stands to gain more from widespread participation in the OneCode ACS program than it loses by pricing below cost on one part of the address hygiene process. In other words, the savings in operations from system wide address quality outweighs the cost to provide the automated address correction notices. Witness Mitchum points out that “putting low cost automated address changes in the hands of customers has the potential to reduce the amount and cost of undeliverable as addressed mail” (USPS-T-40, p. 10).

There is a reasonable basis for distinguishing between the first notices and subsequent notices, because the USPS wants to provide an incentive to mailers to update their files and not simply rely on indefinitely repeated address corrections. Some mailers would rather have free or reduced rate corrections for a specified

period of time rather than having this limited to two occurrences, because they may have more than two mail pieces to the same address in processing at the same time. The costs for automated corrections of letters using PARS do differ by mail class, according to USPS witness Cutting (USPS-T-26, p. 12), but not enough to account for the proposed price difference between First-Class and Standard automated corrections.

Nonetheless, the USPS should be commended for having the foresight to price at least some address corrections below cost. It is evident that this reasoning did not carry over to the pricing of Confirm scans, which make each scan a mini-product that then must cover its costs and make a contribution to institutional costs. The Postal Service is not only pricing Confirm with a narrower focus in 2006 than it did in 2002. It is also pricing Confirm with a narrower focus in 2006 than it prices OneCode ACS for First-Class letters in 2006. This is not a consistent pricing approach, either between rate cases or within the current case.

GHS accepts price differentiations based on cost, but opposes arbitrary pricing of costless scans that differs by mail class within market dominant categories. Particularly in the case of service performance measurement data that mailers and the public need in order to make the best use of a service for market dominant categories in which by definition few alternatives exist, there is no sufficient justification for this price discrimination.

NEITHER INTRINSIC NOR INSTRUMENTAL VALUE BASED PRICING IS APPROPRIATE FOR CONFIRM SCANS

Value based pricing in the repositionable notes case was based on the USPS capturing value that is said to be provided to mailers in the class paying the higher (by 3-to-1) price. Value based pricing for Confirm is based on protecting the relative value of First-Class, and not on an assertion that Confirm is more valuable for the classes for which the higher (by 5-to-1) price is charged.

USPS witness Mitchum explains that the USPS developed its proposal by first deciding on per scan pricing, then on setting a favorable price for First-Class, and only after that on the 5-to-1 ratio between other classes and First-Class. This is no longer intrinsic value pricing, as the USPS claimed to be practicing in the repositionable notes case, but rather it is instrumental value pricing. In other words, the USPS does not claim that higher value is inherent in the scans for other classes. If it were inherent, as GHS has argued, it would be hard to avoid correlating the increased value with the prevalence of less reliable and less consistent service in classes other than First-Class, requiring more hands-on management to achieve the goals of the mailer. The value lies instead in the opportunity for shoring up First-Class mail volume. The Postal Service concedes as much by saying that “the Postal Service proposal for Confirm service builds additional value for First-Class mail” (USPS Initial Brief, p. 382).

Charging other classes five times the rate of First-Class without any cost difference being involved is instrumental, in the USPS Confirm pricing proposal, to

preserving value in the class that makes the highest contribution. It is instrumental value pricing, though the Postal Service portrays it more as the byproduct of other decisions. But limits are needed on value based pricing, in both the intrinsic and instrumental form, particularly when there is no cost factor involved. Limits on value pricing are especially relevant when a secondary product is created whose intrinsic value in other classes is correlated with the lower levels of service for the primary product in comparison with First-Class service. GHS contends that one such limit should apply in the case of pricing service performance data for market dominant categories.

THE CONFIRM PROGRAM AND THE DMCS LANGUAGE ON STARTING THE CLOCK ARE TOO IMPORTANT TO ALL PARTIES TO BE UNDERMINED BY THE USPS PROPOSALS IN R2006-1

How much mail is actually tracked through the use of PLANET codes? Not considering parcels, there may be as many as 200 billion pieces that are capable of bearing a PLANET Code and, if the piece is machinable, having that code read by USPS equipment. But considering available estimates of total scans divided by average scans per mail piece, only about four billion pieces will be tracked in the test year.

The USPS, the mailing industry and the public would all benefit if this ratio of tracked to untracked mail could be increased, and with the new postal law, the regulator should take an increased interest in this topic as well. Confirm, combined with the DMCS language on starting the clock, as the Postal Service foresaw in 2002, is the most robust and cost effective measurement tool yet

developed, and has too much importance to all parties to be a pawn in a battle over the permitted extent of discrimination by mail class in pricing costless data that many mailers need to use the mail effectively.

Yet we see in the current case the Postal Service first trying to withdraw the DMCS language that it had originally insisted upon, then reversing course again by announcing its willingness to keep the DMCS language on starting the clock in place after all. In the initial brief of the USPS, it is stated:

By agreeing informally with the OCA not to push elimination of the electronic notice requirement in DMCS 991.31, the Postal Service is signaling its intention not to reduce the utility of Confirm service for assessing service performance. (USPS Initial Brief, p. 386)

GHS welcomes the Postal Service back to the community of users who seek “not to reduce the utility of Confirm service” for measuring service performance, and expects that the new postal law will add some belated urgency to this mission. We hope the USPS can maintain the position on this issue that it held in 2002, continued to hold as late as May, 2006, and then undermined when it filed the R2006-1 Confirm pricing proposal. The process of making service performance measurement work will benefit from involvement of various participants including Confirm end users and resellers. GHS thinks that the next step that needs to be taken “not to reduce the utility of Confirm service” is for the Commission to reject the USPS pricing proposal and to adopt the OCA proposal with its retention of the unlimited tier and its elimination of the discriminatory pricing of costless service performance measurement data differentially by mail class.