

BEFORE THE
POSTAL RATE COMMISSION
WASHINGTON, DC 20268-0001

Postal Rate and Fee Changes,
2006

)
)

Docket No. R2006-1

**REPLY BRIEF OF
ALLIANCE OF NONPROFIT MAILERS,
NATIONAL ASSOCIATION OF PRESORT MAILERS,
NATIONAL POSTAL POLICY COUNCIL,
AND OFFICE OF CONSUMER ADVOCATE
ON PRICING OF CONFIRM SERVICE**

Shelley S. Dreifuss, Director
Office of the Consumer Advocate
901 New York Avenue, N.W.
Washington DC 268-0001
(202) 789-6837
Fax: (202) 789-6819
shelley.dreifuss@prc.gov

David M. Levy
Richard E. Young
SIDLEY AUSTIN LLP
1501 K Street, N.W.
Washington DC 20005
(202) 736-8000
dlevy@sidley.com

*Counsel for Alliance of Nonprofit Mailers,
National Association of Presort Mailers,
and National Postal Policy Council*

January 4, 2007

TABLE OF CONTENTS

I. THE COMMISSION SHOULD RETAIN A RATE DESIGN FOR CONFIRM SERVICE THAT INCLUDES A SUBSCRIPTION TIER WITH UNLIMITED SCANS.3

II. EVEN IF A PER-SCAN CHARGE FOR EVERY SCAN WERE APPROPRIATE, THE POSTAL SERVICE HAS FAILED TO SHOW THAT A FIVE-TO-ONE PRICE DISPARITY BETWEEN SCANS FOR FIRST-CLASS AND STANDARD MAIL IS CONSISTENT WITH THE ANTIDISCRIMINATION PROVISIONS OF 39 U.S.C. § 403(C).....10

CONCLUSION13

**REPLY BRIEF OF
ALLIANCE OF NONPROFIT MAILERS,
NATIONAL ASSOCIATION OF PRESORT MAILERS,
NATIONAL POSTAL POLICY COUNCIL,
AND OFFICE OF CONSUMER ADVOCATE
ON PRICING OF CONFIRM SERVICE**

The Alliance of Nonprofit Mailers (“ANM”), National Association Of Presort Mailers (“NAPM”), National Postal Policy Council (“NPPC”), and Office of Consumer Advocate (“OCA”) respectfully submit this reply brief on the pricing of Confirm service.

INTRODUCTION AND SUMMARY

The initial briefs reveal an overwhelming consensus among the Postal Service’s stakeholders that the existing unlimited-scan tier of Confirm service should be preserved – and, conversely, that the Postal Service’s proposal to eliminate that tier should be rejected. See ANM-NAPM-NPPC-OCA Brief on Confirm Pricing (“ANM-NAPC-NPPC-OCA Br.”) at 25-27; Initial Brief of GrayHair Software (“GHS Br.”) at 1-24; Initial Brief of Major Mailers Association on Selected Special Service Issues (“MMA Br.”) at 21-28; Initial Brief of the Office of Consumer Advocate (“OCA Br.”) at 109-141. The *only* participant supporting abandonment of the existing rate structure is the Postal Service itself. See Initial Brief of the United States Postal Service (“USPS Br.”) at 379-387.

The Postal Service correctly notes that Confirm pricing “has received considerable attention in this proceeding” (USPS Br. at 379), but totally disregards the reason for that attention: The Postal Service is proposing a radical transformation of the current rate structure for Confirm, including the elimination of the unlimited-scan tier, without providing any evidence that such a destructive course is necessary. If the pricing issue has received an “inordinate amount of attention,” as the Postal Service

contends (*id.* at 383), it is only because the Postal Service continues to urge the adoption of a proposal that all the Postal Service's stakeholders regarded as misguided and harmful. Rather than exercise restraint on this issue, the Postal Service's brief continues to defend the proposal—euphemistically described as an “enhancement” to Confirm (*see id.* at 1)—with arguments that either ignore the public statements of its own management regarding Confirm service or have no basis in fact.

The initial brief of ANM, NAPM, NPPC, and OCA addressed virtually all of the arguments made in the Postal Service's brief, which does little more than repeat arguments made by its witness Mitchum. Consequently, rather than burden the Commission with the same arguments that they made in their initial brief, ANM *et al.* will confine this reply brief to a few points.

First, the Postal Service's brief completely ignores most of the arguments made against its own proposal. Most strikingly, the Postal Service ignores statements made by its own management that totally contradict the proposal it makes here.

Second, contrary to the Postal Service's claim, its proposed restructuring of Confirm pricing would substantially diminish the utility of Confirm as a measure of service performance. As Postal Service management have recognized, the effectiveness of Confirm as a performance measurement tool depends on widespread usage of the service. The record, however, shows that the Postal Service's proposal, if adopted, would lead to a significant decline in usage, thereby reducing the ability of Confirm to gauge the service's performance.

Third, the Postal Service has provided no support for its proposal to charge five times as much for scans of Standard mailpieces as for scans of First-Class mailpieces. Such a practice would be classic price discrimination, since the marginal cost of

scanning a mailpiece does not vary by class of service. Although the Postal Service argues that charging more for Standard mail would “build additional value” into First-Class mail, that reasoning is specious because it would justify *any* price discrimination, no matter how extreme. Because the Postal Service has provided no viable value-of-service justification that would pass muster under the antidiscrimination provisions of 39 U.S.C. § 403(c), the Commission’s prior precedents require that its proposal be rejected.

ARGUMENT

I. THE COMMISSION SHOULD RETAIN A RATE DESIGN FOR CONFIRM SERVICE THAT INCLUDES A SUBSCRIPTION TIER WITH UNLIMITED SCANS.

The Postal Service’s brief ignores most of the various arguments that demonstrate the lack of merit in its proposed transformation of the Confirm pricing structure, including its proposed elimination of the unlimited-scan (Platinum) subscription tier. Most strikingly, the Postal Service does not even mention the May 2006 presentation of Nick Barranca, the Postal Service’s Vice President for Product Development, and the Postal Service official responsible for Confirm service, to the International Conference on Postal Automation. See 33 Tr. 11332 (Mitchum) (acknowledging that Mr. Barranca “is the vice president under which the [Confirm] product falls”); 33 Tr. 11417-11427 (Barranca presentation). In that presentation, Mr. Barranca strongly defended the existing Confirm program, including its rate structure, and explained why a transaction-based rate structure like that proposed by the Postal Service here should *not* be adopted. See, e.g., ANM-NAPM-NPPC-OCA Br. at 1-2, 6-8, 10-13, 15-17, 26, 30-31, 40.

The Postal Service’s silence cannot be inadvertent. Mr. Barranca’s presentation, including its inconsistency with the Postal Service’s current proposal regarding Confirm,

was raised by participants early in this proceeding, and was discussed extensively during the cross-examination of Mr. Mitchum. See Bellamy Direct (GHS-T-1) at 5, 18-19; 33 Tr. 11331-11333, 11345-11347, 11351-11352, 11364 (Mitchum). Given the utter refusal of the Postal Service even to acknowledge (much less discuss) Mr. Barranca's statements before the filing of reply briefs – when other participants will have no chance to respond – any new arguments offered by the Postal Service in its reply brief (including any “spin” that the Postal Service might give to Mr. Barranca's statements) should be given no weight.

Similarly, the Postal Service offers little or no response to most of the numerous issues and arguments that the other participants have raised regarding Confirm pricing. The Postal Service, for example, fails to offer any meaningful response to the following points made in the ANM-NAPM-NPPC-OCA Brief:

- Confirm service is critically important and beneficial to mailers, the public, and the Postal Service itself. ANM-NAPM-NPPC-OCA Br. at 6-10.¹

¹ Although the Postal Service contends that “Confirm service does not work well for the Postal Service as a performance measurement tool,” it then states (inconsistently) that its agreement not to “push” elimination of the electronic notice requirement “signal[s] its intention not to reduce the utility of Confirm service for assessing service performance.” USPS Br. at 386. In any event, the Service's attempt to minimize Confirm's utility as a performance measurement tool is inconsistent with Mr. Barranca's presentation made little more than six months ago. See 33 Tr. 11427 (“Confirm constitutes a key step in providing a value-added service not just in delivery of mail, but also in delivery of information. This information is used by the USPS as a performance measurement tool and facilitates a proactive approach to assess and correct mail processing inefficiencies”). Mr. Mitchum himself conceded on cross-examination that Confirm provides the Postal Service with “a new tool for identifying and resolving mail processing flow problems.” 14 Tr. 4180 (Mitchum). Moreover, although the Postal Service contends that it “developed its own process” of adding Planet Codes to pieces in the mail stream to assess service, Mr. Mitchum testified that the Postal Service's “process” (footnote continued on the next page)

- Eliminating the unlimited-scan tier would damage or destroy Confirm, because any transaction-based price would substantially exceed the marginal cost of additional scans (which is virtually zero), thereby causing many users of Confirm to restrict usage – a result that would reduce the effectiveness of Confirm. *Id.* at 10-12.
- The Postal Service’s decision to abandon the existing rate design for Confirm was uninformed by any meaningful attempt to determine the views of Confirm users regarding either the Postal Service’s proposal or the OCA’s proposal. *Id.* at 14.
- There is no basis for the Postal Service’s argument that the current rate design for Confirm cannot generate sufficient revenues to cover Confirm’s costs, given that: (1) existing revenues fall short of expected costs by only about 15 percent in the Test Year; and (2) the assumptions underlying the Postal Service’s position grossly understate the benefits derived by the Postal Service from Confirm, including the increased postage revenue that the Service receives as a result of the greater demand for underlying mail service that Confirm stimulates. *Id.* at 16-22.
- There is no credible evidence supporting the Postal Service’s position that recovering the costs of Confirm solely through increased subscription fees (as the OCA proposes) will overly suppress demand for Confirm or cause customers to move to a lower subscription tier. In reality, as Mr. Barranca recognized last May and the Postal Service recognized in Docket No. MC2002-1, it is the elimination of the unlimited-scan option that is likely to inhibit use of Confirm. *Id.* at 22-26.²

uses the same program as that used for Confirm service. USPS Br. at 386; 14 Tr. 4179 (Mitchum).

² Rather than address the issue of whether its own proposal would result in a reduction in Confirm usage, the Postal Service argues that the OCA proposal – which would retain the existing subscription-based pricing structure – would have the same effect. USPS Br. at 383-384. But that claim rings hollow, because the Postal Service made no attempt to elicit the views of subscribers regarding the OCA proposal. ANM-NAPM-NPPC-OCA Br. at 14. Moreover, the Postal Service’s claim that witness Bentley “disagrees with witness Callow’s assumption that a 95 percent increase in the Platinum tier fee [as proposed by the OCA] would not reduce the number of Platinum subscribers” (USPS Br. at 384) quotes selectively from Mr. Bentley’s response. Mr.

(footnote continued on the next page)

- The Postal Service’s concern that seeking to recover the revenue shortfall for Confirm by increasing existing subscription fees would increase “arbitrage” opportunities is unfounded. *Id.* at 26-34. Indeed, although the Postal Service expresses the same concern in its brief (without offering any evidence to support it), it acknowledges that “arbitrage has not been a substantial problem for Confirm to date,” and acknowledges the “provision of value added services to consumers” by resellers. USPS Br. at 380, 385.
- Eliminating the unlimited-scan option will not promote fairness and equity among mailers. The Postal Service’s argument that its proposal will be fairer and more equitable to smaller-volume users of Confirm is based on flawed assumptions, is inconsistent with its position only four years ago in Docket No. MC2002-1 (where it defended the existing rate structure as fair and equitable), and cannot be reconciled with its current position that declining block volume discounts in negotiated service agreements are fair and equitable. The very fact that no participant here has supported the Postal Service’s proposal belies any notion that the existing rate structure is “less” fair and equitable to small and medium-size mailers. See ANM-NAPM-NPPC-OCA Br. at 34-39.³

Bentley made clear that MMA’s members prefer the OCA’s proposal to that of the Postal Service:

No, I do not agree with OCA witness Callow’s assumption. MMA members are concerned with increases of that kind of magnitude. *However, it is my understanding that, given a choice between the OCA’s proposal and the Postal Service’s proposal, MMA members favor the OCA’s proposal.*

Response of Witness Bentley To USPS/MMA-T1-19 (21 Tr. 7896) (emphasis added). In its initial brief, the MMA reiterates that it prefers retention of “the existing rate structure, including the Platinum subscriber level with unlimited scans,” if witness Bentley’s proposed alternative (which also would provide for unlimited scans) is not adopted. MMA Br. at 26.

³ In its brief, the Postal Service contends that its proposal would improve fairness and equity because “those that make greater use of the service would pay more.” USPS Br. at 381. This argument ignores the Service’s position not only in Docket No. MC2002-1, but also in other proceedings where it defended the fairness of declining block volume (footnote continued on the next page)

- The existing three-tier rate structure is not unduly complex. By contrast, elimination of the unlimited-scan tier would make the Confirm rate design more complex by (*inter alia*) requiring former Platinum subscribers to start counting the number of scans they used to ensure that the Postal Service is charging them the correct amount. *Id.* at 39-41.
- The Postal Service has failed to establish any incompatibility between the OCA's proposed rate design and future enhancements to Confirm. *Id.* at 41-42.⁴

The various arguments that the Postal Service does make in support of its position warrant little discussion here, because they have either already been addressed in ANM-NAPM-NPPC-OCA's initial brief or are patently frivolous. However, the Postal Service's claim that its proposal "does nothing to change the potential role that the Confirm infrastructure may or not play" in measuring service performance (USPS Br. at 386) warrants some discussion—because that claim is so flatly wrong.

In asserting that its proposal would not affect the utility of Confirm as a performance measurement tool, the Postal Services focuses on the issue of whether it will continue to offer Confirm service, and asserts that it will. See USPS Br. at 386. But the Postal Service ignores a second, and at least equally important, issue: whether, if the Postal Service's proposal is adopted, enough *mailers* will use Confirm, for a

discounts, which (like the declining block aspect of the existing Confirm rate structure produced by the unlimited-scan option) tend to offer service at lower effective rates per unit at *higher* volumes than at lower volumes. See ANM-NAPM-NPPC-OCA Br. at 36-37.

⁴ Like Mr. Mitchum, the Postal Service's brief is able to cite only the scanning of containers as an example of an "enhancement" whose implementation would be facilitated if its proposed rate design is adopted. See USPS Br. at 382-383. But the Postal Service has provided no estimate of the "development costs" that would be "saved" by adoption of its proposal, and the Service has not even announced a roll-out date for the scanning of containers. See *id.*; ANM-NAPM-NPPC-OCA Br. at 41-42.

sufficiently large volume of mail, to preserve the credibility of Confirm data as a measure of the Postal Service's service performance. As Mr. Barranca stated this past May:

Confirm was a service that would benefit not only postal customers, but also present the USPS with a novel view of its operations that may lead to important performance measurement benefits. While customer benefits begin to accrue at almost any level of usage, *USPS' greatest benefits were expected to flow from widespread usage of the product. This attribute, it was determined, justified a pricing stance that promoted product usage.*

Barranca Presentation at 7 (33 Tr. 11423) (emphasis added). Mr. Kiefer made the same point, in almost identical language, when testifying on behalf of the Postal Service in Docket No. MC2002-1. Kiefer Direct Testimony in MC2002-1, at 3 (reproduced at 33 Tr. 11429 *et seq.*).

The record shows that the Postal Service's proposal would *not* generate sufficient usage to make Confirm a credible performance measurement tool. As Mr. Barranca recognized, a transaction-based pricing structure like that proposed by the Postal Service "would lead some potential customers to restrict usage by barcoding only some mailings, or by just 'seeding' barcoded pieces in larger mailings." Barranca Presentation at 8 (33 Tr. 11424). The resulting reductions in usage "both would diminish the value of the information received by the customer but, *more critically, impair use of the Confirm product for measuring operational performance.*" *Id.* (emphasis added). With decreased usage, Confirm data would become spottier, with lower sampling rates, more limited geographic coverage, reduced statistical robustness, and declining credibility. Under such circumstances, mailers could not rely on the reports generated from Confirm usage as a true reflection of the Postal Service's performance. Moreover, the Postal Service could more easily reject any claims of

substandard performance based on Confirm as local in nature, unrepresentative, and/or insignificant.

By limiting the utility of Confirm as a performance measurement tool, the Postal Service's proposal would also frustrate one of the goals of the recently-enacted Postal Accountability and Enhancement Act, Public Law No. 104-435 (120 Stat. 3198). The Act requires the Postal Service to establish rules defining service standards for market-dominant products. See Pub. L. No. 104-435, § 301 (adding new Section 3691 to Title 39). The Act provides that the standards must be designed, *inter alia*, to "enhance the value of postal services to both senders and recipients," "reasonably assure Postal Service customers delivery reliability, speed and frequency consistent with reasonable rates and best business practices," and "*provide a system of objective external performance measurements for each market-dominant product as a basis for measurement of Postal Service performance.*" *Id.* (to be codified at 39 U.S.C. § 3691(b)(1)(A), (B) and (D)) (emphasis added). These provisions reflect a legislative intent to "mandate transparency of the Service's finances, costs, and operations." *Congressional Record*, December 8, 2006, at H9181 (remarks of Representative McHugh and Representative Davis of Virginia). In view of the Act's goal of transparency, and its recognition of the importance of performance measurements, this is no time to adopt a proposal which, like the proposal made by the Postal Service, would substantially weaken the actual and potential effectiveness of one of the few performance measurement tools that mailers currently have available.

II. EVEN IF A PER-SCAN CHARGE FOR EVERY SCAN WERE APPROPRIATE, THE POSTAL SERVICE HAS FAILED TO SHOW THAT A FIVE-TO-ONE PRICE DISPARITY BETWEEN SCANS FOR FIRST-CLASS AND STANDARD MAIL IS CONSISTENT WITH THE ANTIDISCRIMINATION PROVISIONS OF 39 U.S.C. § 403(c).

Even if the per-scan charge proposed for the Postal Service is appropriate (and it is not), the Commission should reject the Postal Service's attempt to introduce inter-class price discrimination. Under the Postal Service's proposal, each scan of First-Class mail would cost one unit, but scans of standard mail would cost *five* units. Scans of Standard mail would also be five times costlier than scans of First-Class mail in dollars-and-cents terms. Because the Postal Service has offered no defensible basis for a price discrimination of this magnitude, the Commission must find as a matter of law that the Postal Service has failed to meet its burden of justifying the disparity under 39 U.S.C. § 403(c). ANM-NAPM-NPPC-OCA Br. at 42-45.

The Postal Service defends the "five-to-one" disparity on the theory that charging more for Standard mail scans "builds additional value for First-Class Mail by ... providing a lower effective price for First-Class Mail." USPS Br. at 382. But if that defense, without more, were sufficient to satisfy Section 403(c), it would justify *any* price discrimination, no matter how extreme. By definition, price discrimination "builds additional value" into the preferred service by giving it a "lower effective price" than the disfavored service. Thus, if a five-to-one disparity were deemed proper because it "builds additional value" into the preferred class of service, the same rationale would justify a disparity of 50-to-1—and greater disparities (such as 500-to-1 or 5,000,000-to-1) would be even more "justified."

The Commission has previously found that the type of justification offered by the Postal Service here is insufficient to meet the requirements of Section 403(c). For example, in the *Repositionable Notes Provisional Service Change* proceeding (Docket

No. MC2004-5), the Commission declined to recommend on a permanent basis “value-based” prices proposed by the Postal Service for repositionable notes (“RPNs”) because the Postal Service had failed to show that the rates would satisfy the requirements of Sections 403(c), 3622 and 3623. Other participants had challenged the proposed RPN rates—0.5 cents for an RPN affixed to a First-Class mailpiece, and 1.5 cents for an RPN affixed to a Standard or Periodical mailpiece—not only because the service was costless (thereby singling out users of RPN to shoulder an extra share of institutional costs beyond that borne by other mailers), but also because the proposed surcharge for Standard and Periodicals mail was three times as high as that for First-Class mail.⁵ The Postal Service justified the difference in surcharges for First-Class Mail and other types of mail as a “reasonable reflection of their differences in added value.” *RPN Decision* at 23.

The Commission, however, made it clear that such price disparities violate Section 403(c) unless the Postal Service demonstrates that the disparities are justified by the greater intrinsic value of the service being charged the higher price. Although it recommended the proposed surcharges on a provisional basis because the Postal Service bears a “lighter burden” when seeing approval of rates for a provisional service, the Commission determined that “The record support for [the Postal Service’s] conclusions would not be adequate to support a set of permanent RPN rates.” *Id.* The Commission reasoned that “the burden would normally be on the Postal Service to demonstrate that its unequal treatment of RPN users might be theoretically justified and correctly applied.” *Id.* at 22-23. Applying that test, the Commission concluded that the

⁵ See *Repositionable Notes Provisional Service Change*, MC2004-5 Op. & Rec. Decis. (Dec. 10, 2004), at 3, 22-23 (“*RPN Decision*”).

Postal Service's rationale for the rate disparity was insufficient to warrant approval of the rates on a permanent basis, because it had "not accounted for a good deal of evidence in the record that runs counter to [the Postal Service's] conclusions." *Id.* at 23. That evidence indicated that imposing the proposed disparity in surcharges be "unfair and probably counterproductive," would have a disproportionately large impact on Standard and Periodical mail, and would produce a far larger percentage increase in the total price for most Standard and Periodical mail than for First-Class mail. *RPN Decision* at 23.

In this proceeding, the Postal Service has not provided the type of justification that the *Repositionable Notes Decision* requires before a rate disparity will be found to pass muster under Section 403(c). Simply alleging that the disparity "builds additional value for First-Class mail" is not enough. The Postal Service has not provided any reasonable justification for *any* disparity, much less a five-to-one disparity, between Standard Mail and First-Class mail. Nor has the Postal Service even explained how it computed a five-to-one disparity (as opposed to some other disparity).⁶ Because the

⁶ Although the Postal Service cites a statement in witness Bentley's response to one of its discovery requests as support for its argument that the price disparity "builds additional value for First-Class mail," its reliance on that statement is misplaced. See USPS Br. at 382 (quoting witness Bentley's statement that "[I]t makes sense to add such value only to First-Class Mail workshared mailers that make a unit contribution to institutional costs that is more than *twice* the unit contribution to institutional costs that Standard mailers make") (emphasis in original). Immediately before making this statement, however, Mr. Bentley made clear that he took no position with respect to the issue of the pricing of scans for Standard mail – a statement omitted from the Postal Service's brief. See *id.*; Response of Witness Bentley to USPS/MMA-T1-22 (21 Tr. 7900) ("The purpose of my testimony is to evaluate issues that relate to First-class mailers in general, and First-class workshared mailers in particular. Therefore, my testimony does not address the pricing of Confirm Service for Standard mail scans. I have not proposed [that] unlimited Confirm scans, with a setup charge of \$2,000, be expanded to include Standard mail scans as well. I have no position with respect to that (footnote continued on the next page)

Postal Service has failed to offer the necessary justification, the Postal Service's proposal must be rejected as a violation of Section 403(c). See ANM-NAPM-NPPC-OCA Br. at 45; see also, e.g., OCA Br. at 131.

CONCLUSION

For the reasons stated herein and in the same participants' initial brief on Confirm pricing, the Commission should reject the radical restructuring of the Confirm pricing structure for Confirm proposed by the Postal Service. To the extent that the Commission believes that adjustments to the existing fees for Confirm are necessary, it should adopt the alternative pricing proposal submitted by the OCA.

Respectfully submitted,

Shelley S. Dreifuss, Director
Office of the Consumer Advocate
901 New York Avenue, N.W.
Washington DC 268-0001
(202) 789-6837
Fax: (202) 789-6819
shelley.dreifuss@prc.gov

David M. Levy
Richard E. Young
SIDLEY AUSTIN LLP
1501 K Street, N.W.
Washington DC 20005
(202) 736-8000
dlevy@sidley.com

*Counsel for Alliance of Nonprofit Mailers,
National Association of Presort Mailers,
and National Postal Policy Council*

January 4, 2007

issue"). See also MMA Br. at 25 n.15 (stating that "MMA takes no position on how Confirm Service should be priced for Standard Mail"). Moreover, even if First-Class mailers make "more than twice" the unit contribution to institutional costs that Standard mailers make, that fact does not justify the *five-to-one* disparity proposed by the Postal Service.

