

**BEFORE THE  
POSTAL REGULATORY COMMISSION  
WASHINGTON, DC 20268-001**

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Consideration of Workshare Discount Methodologies )  
Docket No. RM2009-3 )

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**Initial Presentation of Stamps.com**

Stamps.com, the leading provider of PC Postage, provides its comments in response to the PRC's March 16, 2009 "Notice of Proposed Rulemaking on Application of Workshare Discount Rate Design Principles," PRC Order No. 192.

**I. INTRODUCTION**

Stamps.com's initial presentation addresses the appropriateness of a discount for a type of PC Postage that does not yet exist, but could readily exist: "Qualified PC Postage." The Qualified PC Postage discount would apply to single-piece, automation-compatible, First-Class letters that have addresses cleansed by CASS-certified software, an Intelligent Mail barcode (IMb), and meet Postal Service-prescribed security requirements. Qualified PC Postage would be a close cousin to an existing PC Postage product that possesses all of these features, except that instead of an IMb, it contains a Postnet code and a PLANET code. Qualified PC Postage would allow individuals and small businesses to produce mailpieces with high-quality addresses and an IMb. At long last, these

mailers would be able to participate fully and directly in the benefits of postal automation.

Qualified PC Postage has been in the making for nearly a decade. In Docket No. R2000-1, the Commission recommended a shell classification for PC Postage. *Op.* at 272, ¶ 5190. The time has now come for the Postal Service to take another step forward and create Qualified PC Postage.

#### **A. Procedural Background**

In Docket No. ACR2008, which focused on the Postal Service's FY2008 Annual Compliance Report, Stamps.com suggested that PC Postage discounts would improve the effectiveness of the Postal Service, consistent with the Postal Accountability and Enhancement Act (PAEA). On review, the Commission pointed to the docket's "limited scope" and suggested that the instant docket would provide a better forum.<sup>1</sup> We recognize that this proceeding involves consideration of workshare discount methodologies, and that Qualified PC Postage, depending on how it is characterized, may or may not fall within the scope, but we greatly appreciate the Commission's invitation and in response provide this initial presentation.

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<sup>1</sup> PRC, FY2008 Annual Compliance Determination at 51.

## **B. History of PC Postage**

The Postal Service began the PC Postage Program, also known as the Information Based Indiciium Program (IBIP), in 1996. The first Beta test started in 1998. The program allows customers to use software and/or hardware technologies to print postage directly from their personal computers, using standard laser or inkjet printers. Stamps.com was the first company to attempt the program with a software-only solution. This means that users of our product do not need any special hardware for storage of postage or for printing.

Stamps.com, like all PC Postage vendors, was required to go through three beta phases of product testing before being allowed to release the service commercially. We were audited by the Postal Service to ensure accountability. The Postal Service did final testing on our software and subjected us to a full regulatory review, with special attention to security and revenue protection. We completed the Beta Phases in August 1999, about 3 years after our first software release. On this date, the Postal Service approved Stamps.com Internet Postage and E-Stamp Internet Postage for commercial launch, making these two firms the first two PC Postage vendors.

Today there are four approved vendors, Stamps.com, Pitney Bowes, Neopost, and Newell Rubbermaid's Endicia.<sup>2</sup> Stamps.com provides online postage and shipping software solutions to over 400,000 customers, who printed over \$300,000,000 in postage in 2008. The Postal Service does not pay fees to Stamps.com to develop, maintain, or support its PC Postage products.

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<sup>2</sup> E-Stamp exited the PC Postage program in 2001.

### C. Types of PC Postage

There are several types of PC Postage. Initially, PC Postage was printed on envelopes or labels, and the customer was required to indicate the date of mailing and provide the recipient address. This original product, illustrated in **Figure 1**, enabled customers to print single-piece, automation-compatible letters with cleansed addresses.



**Figure 1. Original PC Postage from 1999**

Today, PC Postage still enables customers to print single-piece, automation-compatible letters with cleansed addresses, as illustrated in **Figure 2**. Plus, these pieces now include the PLANET Code, in addition to the POSTNET Code.



**Figure 2. Original Style PC Postage from 2009**

Our instant proposal would create a new type of PC Postage called "Qualified PC Postage," which would add the IMb to the established product, as shown in **Figure 3**.



**Figure 3. Proposed Qualified PC Postage**

Each piece of Qualified PC Postage would be sender identifiable and fully barcoded, with the code optimally positioned for compatibility with mail processing equipment. Each piece would include a unique IMb, a Facing Identification Mark, and a unique Information Based Indicia (IBI). Each piece

would also include the date of mailing. It is important to note that, unlike a Postnet code, only the mailer can apply a fully-loaded IMb, because it contains information about the mail sender and nature of the mailing. If the Postal Service were to apply a dummy IMb, it would not have a piece number and would lack any information about the sender and the nature of the mailpiece.

All addresses are verified and corrected against a CASS-certified address database. Stamps.com uses its own proprietary CASS-certified software with the Postal Service's AMS (Address Matching System) database to correct the addresses and provide the best possible address match. The AMS system always provides the most up to date delivery point for all addresses.

Stamps.com updates the AMS database on our server monthly, exceeding the requirement for most automation discounts.

The correction and verification process ensures that each address has all the proper elements required for delivery, including the appropriate full delivery point information. To qualify for the discount, the customer will not be able to print the address or postage indicia unless the address has been verified.

Stamps.com has also developed NetStamps® labels, a new form of postage that lets customers print out sheets of generic postage on blank labels, illustrated in **Figure 4**. This type of postage was launched by Stamps.com in 2002. It is not linked to an address or a mailing date, and can be stored for later use, like traditional postage stamps. Stamps.com worked to develop the secure paper that allows this product to meet Postal Service security requirements. Stamps.com was the first vendor to be approved for distribution of this type of

postage. We are not proposing that NetStamps be eligible for the proposed discount for Qualified PC Postage.



**Figure 4. NetStamps**

The next form of PC Postage, also originally invented by Stamps.com, is the shipping label with postage, illustrated in **Figure 5**. Launched in 2002, these labels are automation compatible and have cleansed addresses. Our customers already receive online discounts for printing shipping labels using PC Postage software.



**Figure 5. Shipping Label**

In 2004, utilizing our PC Postage technology, Stamps.com launched PhotoStamps® labels, illustrated in **Figure 6**. PhotoStamps is a new form of PC Postage through which individuals and businesses turn digital photos, designs, or images into valid US postage. PhotoStamps is



**Figure 6 – PhotoStamps**

used as regular postage to send letters, postcards, or packages. The product is available at [www.photostamps.com](http://www.photostamps.com). To order PhotoStamps, customers upload a digital photograph or image file, customize the look and feel, select the denomination, and place the order. Orders arrive via US Mail in a few business days. Stamps.com has shipped more than 70 million PhotoStamps. We are not proposing that PhotoStamps would qualify for the proposed discount.

**D. Current State of PC Postage**

PC Postage has expanded greatly since its debut. Overall, Postal Service revenue from PC Postage has increased each year, from about \$30 million in 2000 to over \$2 billion in 2008. PC Postage is the only Postal Service product category whose volume continues to grow.

While overall PC Postage revenue has expanded, and is expected to continue to do so, the highest quality form of PC Postage – IBIP First-Class letter mail – has languished. We estimate that this form of PC Postage has gone from about 48 percent of postage value in 2000 to about 3 percent in 2008. We believe the relative decline in IBIP First-Class letter mail is due to the lack of a discount. After all, single-piece mailers have other less burdensome options for sending First-Class Mail. Since no discount is offered for the preparation activities required of IBIP Mail, there is little incentive for mailers to embrace it.

## **E. Efficiencies and Cost Savings Inherent in Qualified PC Postage**

By purchasing Qualified PC Postage through Stamps.com or an equivalent provider, individuals and small businesses<sup>3</sup> will be able to present automation compatible pieces that: (a) avoid window service and physical stamps; (b) avoid the need for stamp cancellation; (c) are addressed in standard and complete form to a destination that is certified to exist; (d) have an address that has been cleansed by CASS-certified software; (e) have a full IMb code that identifies the mailer and the mailpiece; (f) can be tracked and traced individually; and (g) enhance the security and reliability of the mailstream.

Without PC Postage software, individuals and small firms are effectively left out of the automation-Internet age. With it, the Postal Service can take a much-needed step toward bringing these mailers into the fold and rounding out its offerings in a way that is consistent with the ideal of a mailstream that is secure, accountable, and low in cost. Movement in this direction will occur more rapidly and equitably with a discount. The reasons for discriminating against these mailers are now things of the past.

PC Postage software is used for a range of applications, including NetStamps, shipping labels for parcels, and PhotoStamps. Users are provided an integrated digital USB scale for weights up to 5 pounds. The discount for Qualified PC Postage would be limited to letter-size, automation-compatible, domestic pieces, with a full IMb code and cleansed addresses.

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<sup>3</sup> Most PC Postage customers are individuals or small businesses.

In these comments, Stamps.com explains why it believes a discount is in order. To the extent detailed specifications and cost support are missing or need further attention, Stamps.com believes that the Commission should encourage the Postal Service to develop the matter further.<sup>4</sup> There are obvious limits to what an outside party can undertake. These limits should be separated from the merits of the proposal.

## **II. HISTORICAL PERSPECTIVE SUGGESTS THAT A DISCOUNT FOR PC POSTAGE IS THE RIGHT STEP**

While the Commission is not beholden to past rationales, particularly in light of the new rate-setting mechanism set out in the PAEA, it is worth noting that Qualified PC Postage would be well justified under the Commission's prior holdings. From the early 1970s onward, the use of technology to prepare mailpieces sparked the very first presort discounts. The progress of technology now allows individuals and small businesses to prepare mailpieces in a way that similarly reduces Postal Service costs and enhances the security and efficiency of postal operations.

**Dockets No. R71-1 and MC73-1 (Phase I).** In the first omnibus rate case under the Postal Reorganization Act (PRA), denominated Docket No. R71-1, Reader's Digest and the Association of Public Utility Mailers argued for a discount for presorted First-Class Mail. In its *Opinion*, the Commission referred

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<sup>4</sup> An example of the Commission encouraging the Postal Service to proceed further is found in the Complaint of Time Warner et al., Docket No. C2004-1, where the Commission's finding No. 3 was: "The Commission recognizes that it is initially the responsibility of the Postal Service to review the materials provided herein and choose a path for improving the efficiency of Periodicals consistent with rates that do not unreasonably impact any segment of that class." Order No. 1446, October 21, 2005, p. 6.

to the proposal as a matter of “rate structure” and noted a Postal Service statement that the idea had “merit.” Nevertheless, in order to keep that docket “within manageable bounds,” it deferred to Docket No. MC73-1, saying that the deferral would “not unduly delay consideration of the issue.” *Op.* at 283-84.

In the deferred-to docket, the Postal Service proposed a discount of one-half cent, revised to one cent in a Stipulation and Agreement (S&A). As summarized by the Commission, the Postal Service explained: “The proposed discount is designed to encourage worksharing which is advantageous to both the Service and the mailer. It is also designed to improve service, and to provide equitable compensation to the mailer who presorts.”<sup>5</sup> *Op.* at 13. The Commission recommended the S&A, acknowledging a Postal Service statement that the “one-cent discount will, on the average, be the equivalent of the clearly capturable cost avoidance” (*Id.* at 16), and found that the discount was “fair and equitable” to “both the user and the Postal Service” (*Id.* at 18), as well as “fair and equitable compensation for mailers who perform pre-mailing separations useful to the Postal Service” (*Id.* at 17).

**Docket No. R77-1.** In Docket No. R77-1, the Commission recommended the Postal Service proposal to increase the discount for presorted letters to two cents. It emphasized that the discount had been established “to encourage worksharing and to provide mailers who presort with equitable compensation for

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<sup>5</sup> On the question of service, the Commission emphasized: “This likelihood of improved service is also significant because first-class and airmail are classifications in which an extremely high degree of reliability and speed of delivery are important.” *Id.* at 18. Airmail was merged with the remainder of First-Class on April 30, 1977. Mailer interest in service is no less today.

the mail processing costs which presorting saves the Postal Service.”<sup>6</sup> *Op.* at 240, footnote omitted. The expected market response to the discount was also discussed.

Considerable attention was paid to the cost support for the discount. The Commission affirmed its focus on the “clearly capturable cost avoidance” (*Op.* at 249-50), and in the end said: “We have concluded that the discount offered for this rate category should be equivalent to its unit avoided costs so that the discount will not alter the net residual cost contribution of first-class as a whole” (*Op.* at 261, footnote omitted).

**ZIP + 4 and barcode discounts.** In addition to presort, a ZIP + 4 discount was implemented in 1983 and a barcode discount in 1988. An outcome of Docket No. MC95-1 was emphasis on automation compatibility, still by presort level. These discounts have all been to recognize the *preparation* of mail by mailers, and they have all been based on clearly capturable savings. The volume of workshared mail has grown substantially. The importance of signals in prices has also been recognized. Particularly in recent years, discussions of discount levels have been couched in terms of Efficient Component Pricing (ECP).

The advent and growth of presort, and the subsequent emphasis on automation compatibility, have paralleled the growth in the use of computers. When a mailer can sort addresses on a computer and then print the pieces in ZIP

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<sup>6</sup> Further on it said the presort category “was primarily intended to bring about a structural reform within first-class mail in order to align rates with costs rather than to give recognition to unique characteristics of presorted first-class mail which would warrant an independent application of all of the § 3622(b) ratemaking criteria.” *Id.* at 247.

Code order, so that the pieces for each ZIP Code area come out neatly in their own trays, it makes no sense for the Postal Service to engage in physical sorting activities. And sorting addresses on a computer is something that mailers can do and the Postal Service cannot.

**Shell Classification for IBIP Prepared Mail.** In Docket No. R2000-1, the Commission recommended a "shell classification" for IBIP prepared mail. The shell classification applied to First-Class letter mail with postage and addressing information printed directly on the envelope and otherwise meeting IBIP requirements, such as address-cleansing by CASS-certified software. *Op.* at 272, ¶ 5190. This is essentially the same product as Qualified PC Postage, but with a Postnet barcode instead of an IMb. The Commission noted that IBIP Mail offered mail processing cost savings and shared many similarities with discounted QBRM mail:

IBIP mail offers the potential for real Postal Service mail processing cost savings. IBIP mail that meets the characteristics described in the recommended shell classification is fully automation compatible, clean mail, with the additional benefit of address hygiene. When examining an IBIP mail piece, there are many striking similarities with QBRM mail such as machine-printed addresses, facing identification marks, proper barcodes (and ZIP Codes), and at least theoretically, correct addresses. These features were very pertinent in recommending a discount for QBRM, and also should be applicable to IBIP mail. [*Op.* at 272, ¶ 5190.]

At that time, PC Postage was still a relatively new product and had generated only \$29.8 million in revenue in FY 2000 (through AP 11). *Id.* at 271, ¶ 5188. The Governors rejected the shell classification, citing the "novelty" of PC Postage and that "PC Postage mail volumes are far from approaching the

volumes projected by IBIP discount proponents.” *Decision of the Governors* at 6. Nearly ten years later, with PC Postage volume having grown by a factor of about seventy, it is now time to reconsider.

**Docket No. R2006-1.** The benefits of mailer worksharing would not have been realized without recognition in rates of attendant cost differences. The Commission has discussed this repeatedly. In Docket No. R2006-1, it said:

The Commission has used Efficient Component Pricing to develop rates wherever possible. Many rates proposed by the Postal Service were not consistent with Efficient Component Pricing as they failed to reflect cost differences fully. Rates that send proper price signals result in more efficient processing and transportation practices, which in turn reduce costs, thereby allowing smaller rate increases, and less volume losses.” [Op. at ii.]

Further along, on page 88, it said: “ECP rates send effective price signals and, as noted above, also have the virtue of being non-discriminatory.”

**Efficient Component Pricing.** Since at least 1990, a guiding policy objective of the Postal Service has been to realize “lowest combined cost.”<sup>7</sup> The reference is to the cost of the mailer plus the cost of the Postal Service, and to keeping this sum as low as possible. The way this is done is to set rates that recognize costs, according to ECP, and to let mailers choose what is best for them. When work is done by the lowest-cost entity, which is what ECP achieves, the combined cost is lowest.

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<sup>7</sup> See Docket No. R90-1, *Opinion* at V-256, and FY 2008 USPS Comprehensive Statement on Postal Operations at 37.

In issues relating to efficient pricing and lowest combined cost, the efficiency of the postal sector and of the nation are at issue. In its FY2008 Annual Compliance Determination, the Commission recognized this, saying:

In the decades before enactment of PAEA the Commission endorsed the principles of efficient component pricing (ECP) when reviewing and designing workshare rate discounts. This rate design method fostered economic efficiency by tying discounts to the costs the Postal Service expected to avoid as a result of mailer worksharing. Consistent application of ECP principles provided needed predictability and stability. While the basic tenets of this method were generally adhered to, the Commission, the Postal Service, and mailers came to recognize through experience that certain circumstances justified variation from rates that strict application of the principle might initially indicate. These principles and exceptions were applied by the Postal Service to build the strongest and most successful postal market in the world. [*Determination* at 45.]

**Ongoing Change.** Presently, two issues are receiving considerable attention. The first is the deficits being experienced by the Postal Service, which make steps to improve the efficiency of the postal sector all the more important. The second is the adoption of the IMb code, which has the potential to increase substantially the overall efficiency of the mailstream.

Essentially, the IMb is an information-rich barcode, placed on the mailpiece by mailers, which contains not only ZIP Code information but also mailer identification and specific-piece identification. This additional information (a) allows service achievement to be measured; (b) provides mailers with service information on their mail; and (c) provides the Postal Service with a diagnostic

tool. In an organization as widely dispersed as the Postal Service, such tools are especially needed. That is, managing the behavior of such an organization is certainly not as easy as it would be if the products were produced under one roof.

A determining feature of the IMb program is that it is dependent on mailer participation. Said another way, it is dependent on mailer *preparation* of the mail. Attention to preparation was emphasized in section 3622(b)(6) of the PRA. Indeed, this section provided the guidance for much of the progress to date in the area of worksharing.

Even more attention is paid to mail preparation in the PAEA. It repeats the admonition of the PRA and adds section 3622(c)(13) highlighting “the value to the Postal Service and postal users of promoting intelligent mail and of secure, sender-identified mail.” Also, it points to “the need for the Postal Service to increase its efficiency and reduce its costs, including infrastructure costs, to help maintain high quality, affordable postal services” (§ 3622(c)(12)) and to the importance of “maximiz[ing] incentives to reduce costs and increase efficiency” (§ 3622(b)(1)). These sections point directly to the IMb and the benefits it can bring.

Shifting emphasis to the IMb expands the role of prebarcoding, particularly since – unlike a Postnet code – the Postal Service cannot apply an IMb. Thus, the additional benefits that are now within reach center on mailer application of this new code. IMb benefits to the postal system cannot be achieved otherwise. Whereas the barcode of the past was an added feature, it is now front and

center. The benefits from adding the code are large instead of small, and mailer participation is essential.

**Setting Is Right for Qualified PC Postage.** In the past, only large mailers have been able to alter their mail preparation and bring about benefits. Individuals and small businesses do not have enough volume to obtain presort discounts, and a degree of sophistication has been needed to improve address hygiene and apply barcodes. Indeed, despite a long history of attention to ways to recognize and encourage low-cost mail from small mailers, including the Commission's recommendation in Docket No. R2000-1 of a shell classification for IBIP Mail, no discounts for any such mailers exist.

Now, however, with the decade-long track record of PC Postage, the possibility exists to allow individuals and small business mailers a seat at the table. And the magnitude of the benefits associated with the IMb, as well as its importance to future postal operations, makes it all the more apparent that it is time to take steps in this direction. In the past, the discrimination against these mailers has been viewed somehow as *due*. It can no longer be viewed that way. These mailers should be allowed to share in the benefits of an improved mailstream.

### **III. RATESETTING CONSIDERATIONS**

**Is Qualified PC Postage Worksharing?** An intriguing question is whether Qualified PC Postage constitutes worksharing, as defined in the PAEA. Certainly, because it involves a barcode, it may be viewed as having workshare

attributes. However, the security features, address-cleansing, and other attributes of Qualified PC Postage are not a result of mailer activities identified by PAEA as "workshare" activities, though they do reduce postal processing costs and enhance the postal system. Whether or not Qualified PC Postage is viewed as encompassing elements of worksharing, it should receive a discount.

Determining what is a workshare discount is not necessarily straightforward. In examining the differences among the bundle rates, sack rates, and container rates in Periodicals in its FY 2007 Annual Compliance Determination, the Commission said: "These price-to-cost ratios are based on estimates of direct costs of various drivers. Therefore, they are not identical to workshare passthroughs, but conceptually are very similar." *Determination* at 87.

Similarly, in its FY2008 Compliance Determination, in a section responding to a range of comments centering on notions of economic efficiency, the Commission said:

In Docket No. R-2006, the Commission decided that for mailers who might have control over decisions as to mail characteristics such as shape, the ECP concept goes *beyond* worksharing. The Commission in its decision noted that the virtue of ECP or an ECP approach beyond worksharing is that it continues to promote productive efficiency. [*Op.* at 37, emphasis added.]

Though it may not be clear what constitutes worksharing, it is clear that costs are important to efficiency, that ECP can be a useful guide to how costs should be recognized, and that cost recognition beyond matters of worksharing is important.

The PAEA contains language that, in certain circumstances, could arguably constrain discounts that are solely matters of worksharing. See 39 U.S.C. § 3622(e). These constraints do not apply to rate differences (or discounts) that are not matters of worksharing. To the extent these constraints even arguably apply, they apply only to discounts provided for PAEA-specified activities undertaken by mailers, activities which must involve one or more of presorting, prebarcoding, handling, or transporting. See 39 U.S.C. § 3622(e)(1). Only one of these activities, prebarcoding, is relevant to Qualified PC Postage. Interestingly, the PAEA uses the term "prebarcoding," not the simpler term "barcoding." This choice of words further shows that the key workshare element is the mailer's pre-application of a barcode to the mailpiece before it reaches the Postal Service. The steps necessary to formulate the particular barcode (i.e., creating the correct IMb based on the address, sender ID, and mailpiece information) are thus not necessarily "workshare activities" under this section of the PAEA.

While barcoding is an important element of Qualified PC Postage, there is much more to it than that. Transforming a mailpiece into Qualified PC Postage requires the mailer to engage in an advanced kind of barcoding that identifies the sender and the mailpiece. The mailer must also engage in other activities, such as cleansing the address with CASS-certified software. The mailer is also identified, increasing the security of the system, and all of this must be done in a secure way. Thus, to any extent to which Congress's focus on "prebarcoding"

was meant to include the activity of supplying an IMb code,<sup>8</sup> Qualified PC Postage may be viewed as having in it an element of worksharing, but it also goes well beyond worksharing.

The fact that Qualified PC Postage may have in it an element of worksharing does not limit its cost avoidance to that element, nor does it reduce the efficiency properties of ECP as a guide to ratemaking. All that is known about efficient ratesetting is applicable.

A question that always arises when avoidances are considered is that of an appropriate benchmark, which often leads to questions of conversion and reversion. In its *Opinion* in Docket No. R2000-1, in a section dealing with the presort discounts in First-Class, the Commission said: “The Commission also views a benchmark as a ‘two-way street’. It represents not only that mail most likely to convert to worksharing, but also, to what category current worksharing mail would be most likely to revert if the discounts no longer outweigh the cost of performing the worksharing activities.” *Op.* at 241, ¶ 5089.<sup>9</sup>

When the question of a discount for PC Postage arose in Docket No. R2000-1, considerable discussion centered on the origin of pieces converting to PC Postage and on the destination of pieces reverting. *See generally Op.* at 263-274, ¶¶ 5164-5195. Whatever the right answer is, it is clear that the pieces converting must: (a) stop buying postage in another way; (b) apply an IMb code

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<sup>8</sup> Since Congress discussed the IMb code separately in section 3622(c)(12), grouping it with issues of security and sender identification but not mentioning worksharing, it is not clear that supplying an IMb code is a worksharing activity under PAEA. This is discussed further below.

<sup>9</sup> See also Docket No. R2006-1, *Op.* at 133-34, 5109.

with full information identifying the mailer and the piece, and apply a Facing Identification Mark; and (c) apply an address that has been cleansed with CASS-certified software, and it must do all this in a way that enhances security. It is also clear that these steps are worth something to the Postal Service.

Also important is just compensation to mailers who take steps to alter the preparation of their mail. As referenced above, this came up in Dockets No. MC73-1 (where the Commission referred to “provid[ing] equitable compensation to the mailer who presorts”) and R77-1 (where the Commission emphasized that a discount had been established “to encourage worksharing and to provide mailers who presort with equitable compensation”). Similarly, the Commission referred in Docket No. R80-1 to providing compensation for “the mailer’s own contribution to the mailhandling process.” *Op.* at 343. In Docket No. R87-1, the Commission said that its approach would “ensure that parties will be equitably compensated for their efforts” and said that it found “merit in the parties’ arguments that presorters of 3/5 digit mail should be compensated for their mail preparation efforts.” *Op.* at 471-72. In Docket No. R97-1, the Commission referred to “not need[ing] to passthrough more than 100 percent of savings to fairly compensate mailer worksharing.” *Op.* at 493. In Docket No. R2006-1, the Commission said it “believes that mailers who workshare should be rewarded” and referred to the new Periodicals structure as “reward[ing] [workshare activities] more appropriately.” *Op.* at iii and 350, respectively. And in its FY2007 Compliance Determination, it referred to “reward[ing] worksharing savings achieved in a future fiscal year” under the PRA. *Determination* at 8.

When mailers invest in preparation, it is certainly fair to consider whether a discount is warranted. Also, when a range of mailers perform preparation activities, we view it as unjust to compensate some of them and not others, without a good reason. This issue applies to Qualified PC Postage. QBRM has many of the characteristics of Qualified PC Postage and it has received a discount since 1999. Similarly, a number of automation categories receive discounts, including discounted rates for use of the IMb, provided certain minimum volume thresholds are met. Qualified PC Postage creates high quality mail pieces that have many of the same cost saving characteristics as these other categories. Qualified PC Postage should be recognized as well.

**Qualified PC Postage Within a Rate Cap.** Under the PRA, a range of factors was considered in selecting cost coverages (implying revenues) for *subclasses* (and therefore for *classes*), consistent with overall breakeven. Implicitly, costs were central to this process. In a second step, consistent with these coverages, a similar range of factors, including costs, was considered in deciding on levels for the rate elements. Under the PAEA, revenues (implying cost coverages) for *classes* (at a given set of billing determinants) are determined by the cap, unless the Postal Service opts not to receive the full revenues allowed. The consideration of other factors at the level of classes is no longer permitted. In a second step, consistent with these revenues, a range of factors, including costs, is considered in the rate element decisions, within any included products. Neither relative costs nor absolute costs, nor any other factors, can now be recognized in determining the revenues of the classes, and

there are certain constraints on rate differences that are designated to be matters of worksharing. Other than this, the role of costs has not changed. Notions of efficient ratesetting, which recognize costs, elasticities, and other factors, are no less applicable.<sup>10</sup>

The billing determinants are the kingpin that ties the rates to the cap. When the Postal Service proposed its IMb discount, it adjusted the billing determinants to align with the expected usage of the IMb code, consistent with Commission Rule 3010.23(d).<sup>11</sup> It also argued that the IMb discount is not a matter of worksharing and that no cost avoidance exists, saying it is “a policy-based differential to promote adoption of full service so that the promise of Intelligent Mail can be more fully and expeditiously realized.”<sup>12</sup> To make the revenue consistent with the cap, and to account for the IMb leakage, other rate elements, not specified or determinant, were increased. This increase, however,

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<sup>10</sup> In fact, one could argue that appropriate recognition of costs and elasticities is more important under the PAEA than under the PRA. This would be for two reasons. First, because the Postal Service may not be able to achieve breakeven, as appears presently to be the case, it should be interested in doing all that it can under the cap to add to its net income. This can be done by appropriate recognition of costs and elasticities. It is not free to consider non-cost factors and then to set rates to break even anyhow. Second, the PAEA provides more emphasis on lowering costs and increasing efficiency than did the PRA. See especially §§ 3622(b)(1), (b)(5), (c)(7), and (c)(12).

<sup>11</sup> See Commission discussion of billing determinant adjustment, Order No. 191 at 26-29.

<sup>12</sup> See Docket No. R2009-1, RESPONSES OF THE UNITED STATES POSTAL SERVICE TO CHAIRMAN'S INFORMATION REQUEST NO. 2 (February 24, 2009), Question 2d, and Order No. 191 at 26.

was small. The leakage in First-Class is shown in the Commission's workpapers to be approximately 0.09 percent of total First-Class revenue.<sup>13</sup>

Qualified PC Postage should be handled in a way that is similar, but with certain differences. First, a cost avoidance *does exist* for PC Postage, while at the same time an element of a PC Postage discount could be "a policy-based differential." Second, the Postal Service will need to present an estimate of the volume of Qualified PC Postage, which, compared to all First-Class volume, will be exceedingly low. In part, this is because it tends to be used by individuals and relatively small mailers. Third, an appropriate discount will have to be selected, based on the cost avoidance. Fourth, the leakage, however small, will have to be accommodated. The leakage amount will be far too small to have any effect on the basic rate for single-piece letters, even if it were set in tenths of a cent, which it is not. If necessary, any needed adjustments for the small amount of leakage could be readily accommodated by tenth-of-a-cent adjustments in some of the presort and/or automation discounts, or a small adjustment could be made in the level of unused pricing authority.

In making decisions relating to the cap and to the other rates in First-Class, it needs to be kept in mind that Qualified PC Postage is an investment, part of the "promise of Intelligent Mail," as noted above. In its Initial Brief in Docket No. R2000-1, the Postal Service referred to PC Postage as being in its "infancy" (p. VII-61). In its Reply Brief in the same case, it said that "PC Postage technology shows great promise" (p. VI-28). That promise is now at hand.

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<sup>13</sup> Calculated from tab 1 of FCM cap calculations 2009.xlsx, PRC LR-1, Docket No. R2009-2, March 16, 2009.

An additional aspect of this investment is that PC Postage has growth potential. In effect, we believe that price recognition would have an important positive effect, as signals in prices almost always do, and that growth will occur. If the discount, perhaps due to conservation, is reasonably understood to be less than the cost savings, the growth will have a positive financial effect on other First-Class mailers and the Postal Service.

The process of mailers responding to signals and changing what they buy, including growth, is part of the dynamics of price caps. These dynamics are understood and are generally viewed as leading to economically efficient outcomes.<sup>14</sup> A principal justification for implementing caps is an understanding that the agency (in this case the Postal Service) will tend, in large part because of its own financial interests, to recognize elasticities and base rates on costs. This is basically what we are asking for in these comments.

**Costing Considerations.** In general, notions of economic efficiency would suggest focusing on a bottom-up cost for Qualified PC Postage pieces. In some cases, however, particularly when *discounts* are to be provided, a cost avoidance can be a more relevant reference.

Section 3622(e) of the PAEA *requires* a cost avoidance to support a discount that is a workshare discount. And it states that a workshare discount is one provided for one or more of the four mailer activities of sorting, barcoding, handling, and transporting. But, as discussed herein, applying an IMb code is

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<sup>14</sup> For a careful discussion of these dynamics, along with a model and numerical examples, see Crowder, Antoinette and Miller, William C., "PA Dynamic Analysis of USPS Price Capped Standard Mail Rates Under Provisions of the Postal Accountability and Enhancement Act," presented at the Advanced Workshop in Regulation and Competition, 27<sup>th</sup> Annual Eastern Conference, Skytop, PA, May 14-16, 2008.

more than a mere activity of barcoding. And, in key part because the address has been cleansed, preparing a Qualified PC Postage piece involves more than applying an IMb code. Thus, a question is raised about whether Qualified PC Postage is a matter of worksharing, and, if it is, at least in part, about whether the cost avoidance must be limited to the cost effects of the four mailer activities. This is important because the Commission has asked in the past whether the cost avoidance should include non-traditional cost effects, that is, cost effects due to other mailer activities.<sup>15</sup>

The position of Stamps.com is that Qualified PC Postage goes beyond worksharing, that a focus on cost avoidance is nevertheless appropriate, at least as a first step, and that the cost avoidance should include cost effects that go beyond those caused by the mailer activities of sorting, barcoding, handling, and transporting.

As a practical matter, two categories of costs beyond the traditional have been at issue. The first is the costs of stamp manufacturing and distribution. The Commission has expressed a policy preference (grounded in the Universal Service Obligation) not to include these costs. See Docket No. R2000-1, *Op.* at 280-82, ¶¶ 5216-5221. The second is the costs of Undeliverable-as-Addressed (UAA) mail, whether it be forwarded or returned to the sender. The record in Docket No. R2006-1 was limited on this issue (*Op.* at 273, ¶ 5193).

Stamps.com believes that the cost effects of Qualified PC Postage on UAA mail should be included in the avoidance. We say this for two reasons.

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<sup>15</sup> See Docket No. R2000-1, *Op.* at 273, ¶ 5193 and Docket No. R2006-1, *Op.* at 174, ¶ 5254.

First, address hygiene is a key issue for the Postal Service and it is difficult to accept that the intent of the workshare language in the PAEA, or the effect of any other preference, should be to prevent the Postal Service from providing a price signal that would improve address hygiene, lower Postal Service costs, and improve service. Second, so far as we can determine, the costs used to support many or all of the other automation discounts capture the savings due to reduced UAA mail, and thus include any lower costs due to address hygiene. It would seem unfair and discriminatory, as well as ineffective for the Postal Service, to exclude these costs for Qualified PC Postage.

The costing assignment, then, which the Postal Service should undertake, is to specify to some approximation where Qualified PC Postage pieces come from and what the cost effects are when they convert. Consistent with the Commission's findings in Docket No. R2000-1, we believe "that the savings analysis for QBRM may be applicable" (*Op.* at 272, ¶ 5190), and also that any savings in sorting beyond the first sort, perhaps due to lower reject rates, should be recognized as well. In particular, we believe: (1) some Qualified PC Postage pieces would otherwise be handwritten and some would otherwise have a meter strip, (2) none would have an IMb code with the mailer and the piece identified, (3) most would not have a barcode of any type, and (4) none would have a cleansed address.

At this time, we are not proposing that Qualified PC Postage would require a Move Update check, because that is not currently approved for PC Postage, but we are open to working with the Postal Service to add such functionality at a

future date. Even without performing a Move Update check, however, the address-cleansing feature of Qualified PC Postage would still result in a significant reduction in UAA mail. Based on two studies of UAA mail, Stamps.com witness Heselton in Docket No R2000-1 found that 5.15 percent of First-Class Mail was returned to the sender because of address deficiencies that our software would correct.<sup>16</sup> Since then, DPS processing (which changes the role of the carrier) and the implementation of PARS have altered the handling of return-to-sender mail. Using current mail flows and costs, the Postal Service should update witness Heselton's estimates.

Another benefit of Qualified PC Postage needs to be recognized. Qualified PC Postage creates a mailpiece with a mailing date.<sup>17</sup> This is the only type of IMb mail that can be used to measure mail service performance for mail entered by single-piece mailers. From the first Postal Service scan (presumably at the point of origin) to the last delivery or destination scan, the Postal Service will have a reliable system for measuring mail processing performance from multiple address points that it would otherwise be without. This will provide highly useful and actionable information to the Postal Service on potential service performance issues. From a service measurement point of view, Qualified PC Postage pieces are thus comparable to Full Service IMb pieces. Therefore, it

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<sup>16</sup> See Direct Testimony of Frank R. Heselton, Stamps.com-T-1, pp. 12-21, drawing on USPS-LR-I-82 and USPS-LR-I-192. More recently, in Docket No. R2006-1, the Postal Service provided additional UAA analysis, in USPS-LR-L-61 and USPS-LR-L-62.

<sup>17</sup> If the mailpiece is created within 1 hour of the last collection time in the mailer's local area, the software automatically warns the mailer and allows the mailing date to be changed to the next business day.

would seem as deserving of a non-cost-based discount as the pieces scheduled presently to receive such an IMb discount.

#### **IV. PC POSTAGE IS FULLY CONSISTENT WITH THE RATESETTING GUIDANCE IN THE PAEA**

Providing a discount for Qualified PC Postage is fully compatible with the PAEA, which creates a new rate-setting mechanism and adds additional guidance to pre-existing PRA rate-setting factors. This new package of guidance is supportive, even suggestive, of a discount for Qualified PC Postage. The following sections are particularly relevant:

**Section 403(c).** “In providing services and in establishing classifications, rates, and fees ... the Postal Service shall not, except as specifically authorized in this title, make any undue or unreasonable discrimination among users ....”

**Comment:** Users of Qualified PC Postage will engage in considerable preparation efforts. Other mailers who engage in similar preparation *do* receive discounts. Failure to offer a discount for Qualified PC Postage would result in undue and unreasonable discrimination among users.

**Section 3622(b)(1)—an Objective.** “To maximize incentives to reduce costs and increase efficiency.”

**Comment:** For single-piece mail, Qualified PC Postage stands as an example of what low-cost mail should be. To maximize

incentives to create this type of mail, suitable incentives should be provided.

**Section 3622(b)(3)—an Objective.** “To maintain high quality service standards established under section 3691.”

**Comment:** Qualified PC Postage, given its high-quality, automation-compatibility, and address-cleansing features, makes achieving high service standards more likely and less costly to the Postal Service.

**Section 3622(b)(7)—an Objective.** “To enhance mail security and deter terrorism.”

**Comment:** Qualified PC Postage is the most secure form of single-piece First-Class Mail, because users must be identified and registered with their PC Postage service provider, making all such mailpieces traceable to the mailer. Also, compared to meter usage and other forms of payment, the opportunity for fraud is reduced.

**Section 3622(b)(8)—an Objective.** “To establish and maintain a just and reasonable schedule for rates and classifications.”

**Comment:** Given the mail preparation involved and the lower USPS costs that clearly ensue, it appears just and reasonable to

recognize PC Postage with a lower rate. Further, it would seem unjust and unreasonable not to give such recognition.

**Section 3622(c)(1)—a Factor.** “[Take into account] the value of the mail service actually provided each class or type of mail service to both the sender and the recipient ...”

**Comment:** To a sender, the value of sending a mailpiece is the surplus<sup>18</sup> realized. If the surplus is negative, the piece will not be sent. Qualified PC Postage increases the sender's perceived surplus, and thus could be expected to increase the amount of mail sent. There is no reason to believe that the elasticity of Qualified PC Postage mailers would be any lower than the elasticity of other similarly situated mailers. In fact, since PC Postage users are frequently technologically savvy, their elasticity could be relatively high.<sup>19</sup> To the recipient, PC Postage provides a distinctive mailpiece that is fully identified and that (if need be) can be fully traced.

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<sup>18</sup> Surplus is value, beyond price, which is received. If sending a piece is worth 45 cents to a mailer and the postage is 30 cents, the surplus is 15 cents. If sending the piece were worth only 27 cents, the surplus would be negative 3 cents, the mail piece would not be sent.

<sup>19</sup> Cross elasticities, due to the volume of Discount PC Postage being sensitive to its discount, would increase the elasticity of both Discount PC Postage and the default category, and could also be important. Since we believe increased usage of Discount PC Postage would increase the effectiveness of the Postal Service, we believe the existence of cross elasticity supports discount recognition.

**Section 3622(c)(5)—a Factor.** “[Take into account] the degree of preparation of mail for delivery into the postal system performed by the mailer and its effect upon reducing costs to the Postal Service;”

**Comment:** Perhaps the most pertinent feature of Qualified PC Postage mail is its preparation. As discussed herein, Qualified PC Postage would comply with a host of regulations and supply a piece with a mailing date, a full IMb code, and a cleansed address. Most of these requirements exist already for PC Postage – the Postal Service would not impose them unless they were of some value to it. Notably, nothing in this factor indicates that recognition of preparation is limited to activities that might be viewed as matters of worksharing.

**Section 3622(c)(6)—a Factor.** “[Take into account] simplicity of structure for the entire schedule and simple, identifiable relationships between the rates or fees charged the various classes of mail for postal services;”

**Comment:** Qualified PC Postage is a simple and elegant way of providing discounts to individual mailers who meet automation requirements, without undue complications. By contrast, providing a discount for courtesy reply mail would create the need for a 2-stamp system, which surveys have shown might be confusing. This issue does not arise for Qualified PC Postage, where the

software takes care of rating and applying the correct amount of postage.

**Section 3622(c)(12)—a Factor.** “[Take into account] the need for the Postal Service to increase its efficiency and reduce its costs, including infrastructure costs, to help maintain high quality, affordable postal services;”

**Comment:** Qualified PC Postage will increase postal efficiency and reduce the costs of processing and delivery, helping to maintain high quality and affordable postal services.

**Section 3622(c)(13)—a Factor.** “[Take into account] the value to the Postal Service and postal users of promoting intelligent mail and of secure, sender-identified mail;”

**Comment:** Qualified PC Postage is the only way in which individuals and small businesses can participate directly in, and benefit from, Intelligent Mail. In addition, Qualified PC Postage is a highly secure product and creates sender-identified mail.

**Section 3622(e) Workshare Discounts.** “(1) Definition.—In this subsection, the term ‘workshare discount’ refers to rate discounts provided to mailers for the presorting, prebarcoding, handling, or transportation of mail, as further defined by the Postal Regulatory Commission under subsection (a). (2) Scope.—The Postal Regulatory Commission shall ensure that such discounts do

not exceed the cost that the Postal Service avoids as a result of workshare activity, unless—[exceptions listed].”

**Comment:** To the extent that a decision is made to “provide” a discount to Qualified PC Postage users only “for” prebarcoding, then the discount may be viewed as involving a workshare activity. While a discount on this basis would be fully justified, Qualified PC Postage goes beyond worksharing and achieves direct and indirect cost savings through its other characteristics as well.

It is noteworthy that this section does not mention the IMb code, though Congress was well aware of it and mentioned it specifically in § 3622(c)(13). This shows that the IMb is a unique step beyond ordinary prebarcoding. This view is consistent with the operational reality that only the mailer can apply an IMb. The Postal Service can read the address and apply an ordinary Postnet code, but cannot apply an IMb, because the IMb contains, *inter alia*, information about the sender. Accordingly, when the Postal Service proposed the IMb discounts that are scheduled to take effect November 29, 2009, it said they were not matters of worksharing (Order 191 at 26).

If a discount is given for activities that *are* viewed as matters of worksharing, this section makes it clear that an estimate of the avoided cost must be developed and that a passthrough relative to that avoided cost must be calculated. But when a discount is for

activities that go beyond worksharing, or that are not defined as worksharing, the constraints relating to workshare discounts do not apply.

## **V. WHAT SHOULD THE POSTAL SERVICE AND THE COMMISSION DO NOW?**

In Docket No. R2000-1, Stamps.com provided a history of the collaboration and testing that led to the PC Postage program as it then existed, and proposed a discount to recognize it. Saying that the program was in its “infancy” (Initial Brief at VII-61) and acknowledging that each code was “unique, and carries certain security critical data elements” (*Id.* at VII-54), the Postal Service took the position that the question of a discount is one “that merits further study” (Reply Brief at VI-28).

Following its review of a substantial record in that docket, including costing evidence, the Commission recommended a *shell* classification for PC Postage mail, saying: “Although the Commission does not recommend a specific discount for IBIP prepared mail, it finds that the cost savings analysis for QBRM may be applicable in calculating an appropriate discount.” *Op.* at 272, ¶ 5190. In the next paragraph, the Commission explained: “The basis of this recommendation is the belief that IBIP mail offers the potential for real Postal Service mail processing cost savings,” adding that this mail “is fully automation compatible, clean mail, with the additional benefit of address hygiene.” Since that time, the PC Postage product has advanced further, consistent with the “potential” seen by the Commission.

Upon receiving the Commission's recommendation in the R2000-1 docket, the Postal Service did not pursue the shell classification for PC Postage. Instead, the Governors rejected the recommendation, pointing to PC Postage volumes as being lower than some had projected and to "some disagreement even among proponents of a rate discount about whether a discount is vital to the long-term potential growth of IBIP."<sup>20</sup> In addition, they noted "some uncertainty about the potential unit cost savings" for PC Postage and about "what operational changes would need to be made and whether they would be appropriate in the foreseeable future," all things considered. *Id.* at 7.

With nearly 10 years of experience behind us, we now see the effects of the failure to provide a discount for the original most efficient form of IBIP Mail. While the use of PC Postage has greatly expanded (from about \$30 million in 2000 to over \$2 billion in 2008), the use of the original most efficient form of IBIP Mail has remained relatively flat. As a percentage of all PC Postage, it has steadily declined from 48 percent in 2000 to 3 percent in 2008. Because mailers have other PC Postage options, and are given no incentive to create high quality IBIP Mail, this category of mail has not grown to the same extent as other categories.

The revenue generating effects of discounts for online purchase of postage is apparent in other recent examples. Since May 2007, the Postal Service has provided discounts for online purchase of postage for Priority Mail International and Express Mail International, and since May 2008 for domestic

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<sup>20</sup> DECISION OF THE GOVERNORS OF THE UNITED STATES POSTAL SERVICE ON THE RECOMMENDED DECISIONS OF THE POSTAL RATE COMMISSION ON SELECTED MAIL CLASSIFICATION MATTERS, Docket No. R2000-1, December 4, 2000, p. 6.

Priority Mail and Express Mail. PC Postage revenues for these products have grown in excess of 30 percent on an annualized basis – this despite precipitous drops in overall mail volume. For the Postal Service, these discounts have been one of the few bright spots in difficult times, yielding revenue increases far greater than the amount of the discounts.

Now is the time to establish a discount for Qualified PC Postage. Qualified PC Postage incorporates a mailer applied IMb – a key postal initiative that did not exist in 2000. The IMb can be applied only by the mailer, making this a key difference from IBIP Mail. Qualified PC Postage would also provide a way for individuals and small businesses to, in effect, avoid or lessen the impact of annual rate hikes. As the rates for single-piece First-Class mail increase over time, mailers could, in a practical way, preserve or come close to their old rates by switching to Qualified PC Postage. Establishing Qualified PC Postage would also finally allow individuals and small business mailers to produce the same high quality mailpieces as the most sophisticated large mailers, and would enable them to directly and fully participate in the benefits of postal automation.<sup>21</sup>

In Section III, we dealt with several ratesetting considerations, including those of worksharing, the rate cap, and costing. On the latter point, we believe that the cost advantages are real, consistent with the Commission's finding in Docket No. R2000-1, but that the Postal Service could provide the details better

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<sup>21</sup> Stamps.com's interests at this time happen, we think, to coincide with certain interests of the nation. In this great recession, the traditional role of small businesses as the engine of economic growth is more important than ever. We believe a discount small businesses can earn will help.

than we, particularly given on-going activities in connection with the IMb. In Section IV, we explained that PC Postage is fully consistent with the PAEA.

The Postal Service has time for further inquiry before its next annual market dominant rate adjustment. A cost analysis can be completed, even if limited at this point, and presented to the Commission for review and approval. A number of observations on appropriate method were made above in the costing section. It is the suggestion of Stamps.com that the Commission should encourage the Postal Service to take the steps that are needed.

Respectfully submitted,

s/Seth Weisberg

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