

**BEFORE THE POSTAL REGULATORY COMMISSION  
WASHINGTON, DC 20268-0001**

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**Review of Nonpostal Services**

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**Docket No. MC2008-1(Phase II)**

**INITIAL BRIEF OF PITNEY BOWES INC.**

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DATE: July 21, 2009

## TABLE OF CONTENTS

I. INTRODUCTION.....	1
II. SUMMARY OF ARGUMENT.....	2
III. ARGUMENT.....	2
A. The Statutory Scheme.....	2
B. The Commission should not grandfather USPS-branded ink because the private sector is meeting the public need for postage meter supplies.....	4
1. <u>There is no public need for USPS-branded ink</u> .....	4
a. <i>The “access to the mails” argument fails</i> .....	4
b. <i>The “needed revenue” argument is not a public need argument</i> .....	5
2. <u>The private sector is meeting the public need for postage meter supplies</u> .....	6
C. Even if the USPS could satisfy the public need test – which it cannot – the Commission may not grandfather USPS-branded ink because it was not “offered” as of January 1, 2006 as required.....	9
D. If the Commission allows the Postal Service to expand its commercial licensing activities beyond those offered as of January 1, 2006, the Commission must establish a review and approval process to evaluate new licenses.....	10
IV. CONCLUSION.....	12

## I. INTRODUCTION

The Postal Accountability and Enhancement Act (PAEA)<sup>1</sup> prohibits the Postal Service from offering new nonpostal services. *See* 39 U.S.C. § 404(e). In Order No. 154, issued December 19, 2008, the Commission reviewed revenue-generating activities identified by the Postal Service to determine, as required by section 404(e), which should continue as nonpostal services (i.e., be “grandfathered”). A nonpostal service may be grandfathered only if (1) it was offered as of January 1, 2006, (2) there is a public need for the service, and (3) the private sector does not have the ability to meet the public need.

The Commission authorized 14 nonpostal services to continue. *See* Order No. 154 at 3. The Commission deferred ruling on three issues – the licensing of the Postal Service’s brand for use on commercial products related to postal operations, a warranty repair program, and sales of music compact discs. *See id.*, at 4. By Order No. 168, issued January 9, 2009, the Commission initiated the current phase of the proceeding (Phase II) to develop a more complete record on those three services and determine whether they should be grandfathered.

This brief explains why the Commission should disapprove USPS-branded replacement meter ink (USPS-branded ink) as a grandfathered nonpostal service. We explain why the Postal Service has failed to demonstrate a public need for USPS-branded ink. We also explain why USPS-branded ink, a product that was *not* offered as of January 1, 2006, is ineligible for approval as a grandfathered nonpostal service. We further explain why grandfathering USPS-branded ink would be directly contrary to the clear legislative intent of the Congress, by permitting the Postal Service to do indirectly via a commercial license that which the PAEA

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<sup>1</sup> *See* Pub. L. No. 109-435, 120 Stat. 3198 (Dec. 20, 2006). The PAEA amends various sections of title 39 of the United States Code. Unless otherwise noted, section references in this brief are to sections of title 39.

prohibits it from doing directly – offer new revenue-generating activities that are not approved postal services.

## **II. SUMMARY OF ARGUMENT**

Under the PAEA, the Commission, not the Postal Service, is charged with the responsibility to determine which nonpostal services satisfy the statutory limitations of section 404(e). The Commission determines what constitutes a “service,” what new postal services may be offered, what existing nonpostal services may be grandfathered. The Commission further determines how new postal services and grandfathered nonpostal services will be classified and regulated.

USPS-branded ink should not be approved as a grandfathered nonpostal service under section 404(e)(3) because the private sector is meeting the public need for postage meter supplies. Moreover, even if the Postal Service could satisfy the public need test of section 404(e)(3) – which it cannot – the Commission may not grandfather USPS-branded ink because it was not “offered” as of January 1, 2006, as required by section 404(e)(2).

Accordingly, the Commission should determine that USPS-branded ink may not continue as a grandfathered nonpostal service and direct the Postal Service to terminate the offering as required by section 404(e)(4).

## **III. ARGUMENT**

### **A. The Statutory Scheme**

Under the PAEA, the Commission, not the Postal Service, is vested with the authority to determine which Postal Service product offerings are nonpostal services within the scope of section 404(e). Similarly, the Commission is vested with the sole authority to determine which of those nonpostal offerings should continue.

Section 404(e)(3) requires the Commission to “review each nonpostal service offered by the Postal Service . . . and determine whether that nonpostal service shall continue.” Section 404(e)(2) limits the Postal Service’s authority to provide nonpostal services to those it “offered as of January 1, 2006.” The purpose of the Commission’s review under section 404(e)(3) is to determine which nonpostal services should continue, taking into account the public need for the service and the private sector’s ability to meet that public need.

Section 404(e)(4) provides that any nonpostal service that the Commission determines should not continue shall terminate. Any nonpostal service that the Commission determines should continue “shall be regulated under this title as a market dominant product, a competitive product, or an experimental product.” 39 U.S.C. § 404(e)(5).

The PAEA defines nonpostal service to mean “any service that is not a postal service defined under section 102(5).” 39 U.S.C. § 404(e)(1). “‘Postal service’ refers to the delivery of letters, printed matter, or mailable packages, including acceptance, collection, sorting, transportation, or other functions ancillary thereto.” 39 U.S.C. § 102(5).

Accordingly, under the PAEA, the Postal Service is limited to offering either postal services or qualifying and approved nonpostal services, all of which are subject to regulation as market dominant, competitive, or experimental products under chapter 36. *See* 39 U.S.C. § 404(5).

**B. The Commission should not grandfather USPS-branded ink because the private sector is meeting the public need for postage meter supplies**

1. There is no public need for USPS-branded ink

The Postal Service has not established a public need for USPS-branded ink.<sup>2</sup> The Postal Service has offered no evidence – no data, no market surveys, and no information regarding the views of consumers who use the product – that establishes a public need for USPS-branded ink. Instead, the Postal Service offers two arguments. First, the Postal Service asserts that USPS-branded ink meets a public need because “[t]he public needs easy access to the mails.” Supplemental Sworn Statement of Gary A. Thuro (Thuro Suppl.), January 30, 2009, at 5. Second, the Postal Service contends that USPS-branded ink meets a generalized public need because such licensing “provides needed revenue to support [the Postal Service’s] core mission of providing affordable postal services.” Thuro Suppl., at 5. Both arguments are without merit.

*a. The “access to the mails” argument fails*

Consumers looking to purchase postage meter ink can purchase postage meter ink from numerous national, household name retail stores (e.g., Kmart, Office Depot, Walgreens, Staples, Office Max, etc.). Postage meter ink is also available for sale via hundreds of on-line retail and office supplies web sites, including Ebay, Amazon.com, Yahoo.Shopping.com, OfficeWorld.com, and many, many others. *See* Declaration of Peter Wragg (Wragg Decl.), May 11, 2009, at ¶ 16, Ex. 1. Dozens of private label and generic brands of postage meter ink are available through these retail channels.

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<sup>2</sup> The Postal Service bears the burden of proof to establish the public need for USPS-branded ink and to prove that the private sector does not have the ability to meet the asserted public need. *See* PRC Order No. 168 at 1 (“This Order establishes procedures to develop a more complete record on these issues beginning with an opportunity for the Postal Service to present its case on these issues and followed by an opportunity for interested persons to respond.”). This is consistent with the language and structure of section 404(e) and the “default rule” under the Administrative Procedure Act whereby the burden of proof lies with the party petitioning the agency for approval or other requested relief. *See* 5 U.S.C. § 556(d); *Schafer v. Weast*, 546 U.S. 49, 56-57 (2005)(citations omitted).

The Postal Service has offered no evidence that USPS-branded ink increases access to the mails. The Postal Service is not offering a new product. The Postal Service is not using a new distribution channel. The evidence shows that USPS-branded ink is the same product, made available via the same distribution channels, as preexisting brands. Only the packaging has changed. *See* Wragg Decl., at ¶ 18, Ex. 2. Thus, the Postal Service’s entry into the postage meter supplies business does nothing to expand the public’s access to the mails. The Postal Service is simply competing among the same distribution channels within a healthy, mature postage meter supplies market. USPS-branded ink does not expand consumer access to the mails, it merely displaces the services already provided by preexisting private sector competitors. Accordingly, the “access to the mails” argument fails to establish a public need for USPS-branded ink.

*b. The “needed revenue” argument is not a public need argument*

The argument that any activity engaged in by the Postal Service that defrays the costs of core postal functions must be approved under the public need test of section 404(e)(3)(A) is unsupported. First, this argument confuses and conflates the Postal Service’s needs with the public need. This is directly contrary to the statutory limitation on new nonpostal products under section 404(e)(2). Second, the Postal Service has not introduced any evidence that Congress intended such an expansive reading of the “public need” test. The Postal Service has failed to introduce this evidence because there is none. The Postal Service’s “needed revenue” argument (i.e., the public need test is satisfied by any activity that generates revenues to defray the costs of core postal services) must be rejected because it would render the limitations of section 404(e) meaningless. The Postal Service’s expansive interpretation would also subvert one of the fundamental precepts of the PAEA – to focus the Postal Service on its core mission of providing

universal, reliable postal services. For all of these reasons, the Postal Service’s “needed revenue” argument fails to establish a public need for USPS-branded ink.<sup>3</sup>

2. The private sector is meeting the public need for postage meter supplies

The record evidence shows a vibrant, mature private sector postage meter supplies market. There is a wide variety of commercial distribution channels and many, many private sector participants – OEMs and third-party suppliers. The Postal Service has not and cannot introduce any evidence that the private sector does not have the ability to meet the public need for postage meter supplies.

In fact, the evidence submitted by the Postal Service supports the overwhelming conclusion that the private sector *is* meeting the public need. In describing its commercial licensing program, the Postal Service concedes that it is not attempting to fill a void in the market or satisfy unmet consumer demand. Rather, the Postal Service boasts that it “conducts research to identify best-in class” incumbent private sector market participants and “[p]roducts already in the marketplace with a proven track record . . . .” *See* USPS Responses to POIR No. 1, Question 11. In a response to a related question, the Postal Service states:

The Postal Service when evaluating a prospective licensee prior to the execution of any agreement looks at four criteria:

- Their track record in the commercial marketplace as a licensee of a major brand
- Their product presence in established commercial channels
- Their current financial health and company history
- Consumer brand recognition

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<sup>3</sup> According to the Postal Service USPS-branded ink has generated little revenue. *See* Response of the United States Postal Service to POIR No. 1, April 3, 2009, Question 7 (stating that the USPS-branded ink license (LICENS-07-C-1210) had generated only \$17,597.00 in revenue FY 2008). Thus, even under the Postal Service’s own test, USPS-branded ink fails because there is no evidence that this licensing activity is producing any meaningful “needed revenue.” Although the numbers are small, the potential harm to the private sector is significant. USPS-branded ink is a relatively new product. The longer the USPS-branded product remains in the market, the greater the likelihood of market distortion. Prompt termination of the program would impose minimal impact on the Postal Service while protecting a vibrant, healthy private market.

*Id.*, Question 12.

Thus, rather than fill a void of unmet consumer demand, the Postal Service is seeking to take market share within a mature private market by partnering with an established incumbent. By its terms, the statutory limitation in section 404(e)(3)(B) was intended to prevent this behavior. *See* 39 U.S.C. § 404(e)(3)(B). Rather than meeting an unmet public need, allowing USPS-branded ink will harm and distort a mature, functioning private market.

Moreover, the Postal Service's competitive entry into a market over which it also exercises regulatory authority creates an inherent conflict of interest and the potential for abuse and unfair competition.<sup>4</sup> As a competitor in the market, the Postal Service's financial interest in USPS-branded replacement ink cartridges designed to fit an installed Pitney Bowes meter base is in direct conflict with its status as the regulator of the market, with an obligation to fairly and expeditiously review new product innovations that will benefit the mailing public. The Postal Service has an incentive to reward stasis in the market because new product development will diminish the value of the Postal Service license. *See* Wragg Decl., at ¶ 7. As the regulator of postage evidencing systems and meter ink, the Postal Service also has access to confidential commercial information and customer data. No other competitor in the market has access to this information. Pitney Bowes is required to provide this data to the Postal Service. *See* Wragg Decl., at ¶ 9.

The Postal Service exercises regulatory authority over new meter system approvals. *See* Lord Decl., at 1-2. In this capacity, the Postal Service requires private sector ink manufacturers

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<sup>4</sup> In view of the Surrebuttal Testimony of Daniel J. Lord on Behalf of the Postal Service (Lord Decl.), July 6, 2009, it bears noting that Pitney Bowes has not made a particularized allegation of anticompetitive behavior. We commend the hard work, honesty, and talent of the many Postal Service employees with whom Pitney Bowes regularly works. However, these issues are not suited for resolution on the basis of individual personalities; structural protections must be adopted.

to submit “new” ink to the Postal Service for various testing protocols and approval. *See id.*, at 3. The Postal Service is the official authority on whether postage meter ink meets the operational and revenue-security needs of the Postal Service. *See id.*, at 3-4. This regulatory role is entirely appropriate. The postage meter indicium has real monetary value. The quality of the ink is an important factor in ensuring this value.

What is inappropriate is for the Postal Service to act as both a regulator (judge) and competitor in the same commercial market. Basic notions of fairness dictate that the judge cannot also compete. Acting in a dual capacity as both regulator and competitor allows the Postal Service to obtain an unfair competitive advantage by receiving advance notice of new product designs. To the extent the Postal Service – acting as a competitor in the market – uses that information to retool its own products it would unfairly advantage itself relative to other private sector competitors and would deprive Pitney Bowes the benefit of bringing a new product to market. Second, the Postal Service’s dual role also gives it an unfair competitive advantage because consumers of postage meter ink may believe that the USPS-branded product is an “official” product. Because the Postal Service regulates the quality of postage meter ink consumers may also believe that the Postal Service is especially well positioned to develop high-quality ink. Thus, the Postal Service’s dual role also raises consumer protection issues, particularly where, as here, the USPS-branded product is the very same product that was previously available, and currently remains available, under a variety of different brand labels.

Accordingly, the Commission should not grandfather USPS-branded ink to continue because the private sector is meeting the public need for postage meter supplies.

**C. Even if the USPS could satisfy the public need test – which it cannot – the Commission may not grandfather USPS-branded ink because it was not “offered” as of January 1, 2006 as required**

Under the PAEA, the Postal Service is limited to offering only those nonpostal services that were “offered as of January 1, 2006[.]” 39 U.S.C. § 404(e)(2). It is uncontested that the Postal Service was not offering USPS-branded ink as of January 1, 2006. *See* USPS Response to Order No. 126, Attachment at 1; PRC Order No. 171, at 5, n.6. Therefore, USPS-branded ink is not eligible to be grandfathered as a nonpostal service under section 404(e)(2).

The licensing activities engaged in by the Postal Service prior to January 2006 are materially distinguishable from the nature of the licensing activities represented by USPS-branded ink. Thus, USPS-branded ink cannot properly be construed as a logical outgrowth of a preexisting nonpostal service. The Commission suggested in Order No. 154 that the licensing activities the Postal Service has historically engaged in with various novelty items, keepsakes, and apparel (licensing unrelated to postal operations) serve a unique function in marketing the Postal Service’s brand. *See* PRC Order No. 154 at 73. Even if this is true no similar benefit is derived from USPS-branded ink. The primary purpose of USPS-branded ink is not to promote the Postal Service’s brand; it is to promote a commercial product. Only the Postal Service can offer USPS-branded novelty merchandise. There is no risk of unfair competition because the private sector cannot provide the same service. In contrast, the use of the Postal Service name in the commercial context (e.g., USPS-branded ink) is simply a means to leverage the brand to take market share from existing private sector competitors serving the public need in a mature, healthy market.

For these reasons, the Commission’s determination that “licensing of the Postal Service brand for commercial activities” was ongoing on January 1, 2006 is overbroad. *See* Order No.

154, at 71; Order No. 171, at 5 (taking cognizance of the fact that USPS-branded ink was not offered as of January 1, 2006). This determination is unwarranted and inconsistent with the intent of the PAEA. Limiting new revenue-generating licensing activities to those products which are functionally equivalent to the licensing activities offered by the Postal Service as of January 1, 2006 and grandfathered by the Commission, would give effect to the requirements of section 404(e)(2), and better allow the Commission to provide the oversight and accountability required by the PAEA. Accordingly, the Commission should reconsider its determination to deem all licensing activities eligible for approval as grandfathered nonpostal services.

**D. If the Commission allows the Postal Service to expand its commercial licensing activities beyond those offered as of January 1, 2006, the Commission must establish a review and approval process to evaluate new licenses**

Under the PAEA, there are only two types of services; postal services and nonpostal services. *See* Order No. 154, at 9. The Commission determines which existing nonpostal services may be and should be approved under the grandfather authority of section 404(e) and what new postal services may be offered pursuant to the requirements of section 3642. *See* 39 U.S.C. §§ 404(e) and 3642. If approved, nonpostal services are classified as market dominant, competitive, or experimental products and regulated accordingly. *See* 39 U.S.C. § 404(e)(5). Order No. 154 adds an additional responsibility: determining whether new revenue-generating activities may be offered in connection with an approved nonpostal service such as licensing or leasing.

The Postal Service has argued throughout this proceeding that it would be “absurd” for the Commission to review individual licensing arrangements. *See* USPS Response to Order No. 126, at 7-8. But the alternative proposed by the Postal Service – wholesale approval of any future disposition of the Postal Service’s intellectual property on the basis of the one-time review of the limited selection of activities presented for review under section 404(e)(2) – is untenable. *See id.*

Section 404(e) contemplates a one-time review to allow the Commission to determine which preexisting nonpostal services may continue. This is consistent with the command of the PAEA to limit the scope of the grandfather authority to a finite universe of preexisting nonpostal services.

If the Commission does not reconsider its determination in Order No. 154 broadly grandfathering the function of licensing, then the Commission must ensure that future commercial licensing arrangements are subject to review and approval. Absent notice and review, new commercial licensing agreements – however dissimilar in nature from the licensing agreements previously reviewed by the Commission – will exist outside the control of the Commission; a *de facto* “third bucket.” As a practical matter, this would allow the Postal Service to do indirectly that which it cannot do directly – offer new revenue-generating activities that are not approved postal or grandfathered nonpostal services. This is inconsistent with the PAEA’s fundamental commitment to transparency and accountability.

Notice, review, and the opportunity for interested parties to be heard are essential for any new commercial licensing arrangement. Within the current framework, Pitney Bowes anticipates that the follow-on rulemaking (Phase III) will provide an opportunity to address these important issues. *See* PRC Order No. 168, at 1, n.2.



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