

ORIGINAL

BEFORE THE
POSTAL RATE COMMISSION
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POSTAL RATE COMMISSION
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Mailing Online Services)
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Docket No. MC98-1

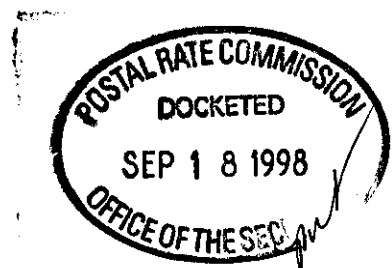
INITIAL BRIEF OF PITNEY BOWES

Pitney Bowes Inc. ("Pitney Bowes") submits this Initial Brief to urge the Commission to impose three fundamental conditions on any market test of Mailing Online that the Commission may recommend:

First. Consistent with its statutory duty to further the national policies favoring fair competition, the Commission should require that the special rate preferences the Postal Service intends to offer Mailing Online users also be made available to any functionally equivalent and competitive service, including Pitney Bowes' DirectNET.

Second. The Commission should require the Postal Service to conduct a new market survey using the actual Mailing Online printing prices.

Third. With a few modifications, the Postal Service should be required to adhere to the OCA's proposed data collection plan.



I. The Postal Service Should Not be Permitted to Gain a Competitive Advantage Over Functionally Equivalent Services Like DirectNET.

This Commission plainly has the statutory authority and the affirmative duty to take into account the impact which proposed Postal Service offerings will have upon private sector competitors. The Commission made this point explicit in its original ECOM Decision. Opinion and Recommended Decision in Electronic Mail Classification Proposal, 1978, Docket No. MC78-3 (December 17, 1979) (ECOM Decision). The Commission stated that “when a regulatory agency is instructed by its governing legislation to fix rates ... or take other regulatory actions as required by the public interest, it must consider competition as a part of that general criteria.” ECOM Decision at 54. Acknowledging that the provisions of the Act that govern rate and mail classification decisions (39 U.S.C. § 3622(b) and 3623(c)) do not use the precise term “public interest,” the Commission concluded that the legislative terms actually used in the postal statute are “functionally equivalent to that standard.” Id. The Commission particularly pointed out that Section 3623(c) (1) demands that classifications be “fair” and that Section 403(b)(1) calls for “an efficient system of collection, sorting and delivery of the mail.” The Commission concluded that these two principal concerns -- fairness and efficiency -- correspond to the traditional concerns of regulatory agencies to promote the competition. It held that

“ . . . [t]he Service itself has an obligation to act in a manner consistent with the national policy in favor of competition. Since our decisions are required to conform to the policies of the Postal Reorganization Act as a whole, that obligation governs us as well.”

ECOM Decision at 57. Indeed, when -- as with Mailing Online -- the Postal Service seeks to engage in activities traditionally performed by the private sector, the Commission has engaged in "intensified scrutiny" to assure that the Postal Service does not use its bottleneck control over the delivery of letter mail to compete unfairly. See also, Opinion and Recommended Decision in Provisional Packaging Services, Docket MC 97-5 at 29 (March 31, 1998).

The Postal Service's Mailing Online Market Test is not "consistent with the national policy in favor of competition." The Postal Service has decided to give itself a competitive edge by granting to itself (and passing through to its Mailing Online customers), discounted postage rates for which the Mailing Online customer and the Mailing Online mailings would not otherwise qualify.^{1/} The Postal Service is well aware that there are already several hybrid electronic/postal services in the market, including Pitney Bowes' DirectNET. However, the Postal Service does not propose to allow these competitive and functionally equivalent hybrid services to invoke the special eligibility rules and pass these discounts on to their customers.

It may well be that when the Mailing Online Service is mature, it will generate volume sufficient to qualify for Standard (A) bulk, and First-Class

^{1/} Entry of mail "using Mailing Online Service" is categorically exempt from the 500 piece minimum otherwise applicable to automation first class mail, from the 200-piece or 50 lb. minimum normally applicable to Standard (A) mail and from the otherwise applicable rule that destination BMC entered Standard (A) discounts apply only to mail actually delivered to the destination BMC. See, Request of United States Postal Service, Attachment A, p. 1.

automation rates and that, dispersion of printing facilities (when finally achieved) will make destination BMC entry feasible under the normal rules. The same, however, can be said for competitive start-up services such as DirectNET. If the Postal Service is entitled to special exemption from normally applicable rules during the start-up period for a new service, national policies favoring competition dictate that its competitors should also be given the same exemption.

The Postal Service's claims that the special discount rules associated with Mailing Online will not cause competitive harm to DirectNET are unconvincing. The claim that DirectNET and Mailing Online are dissimilar as a matter of technology (Tr.2/368-70) is both incorrect and irrelevant. Although DirectNET started out as a "client-based, point-to-point dial-up service", Pitney Bowes introduced an Internet-based service as a part of DirectNET in March of 1998. This service is marketed in alliance with Microsoft in a project in which the Postal Service also participates by providing list hygiene services. Rebuttal Testimony of Patrick Brand at 2/L13-19.

More importantly, the precise communications technology involved in these services is not material. The courts have repeatedly emphasized that the determination of "functional equivalence" is to be made from the standpoint of the customer: "the focus of the test should be practical, oriented to customers..." Ad Hoc Telecommunications Users Committee v. FCC, 680 F.2d 790, 797 (DC Cir. 1982); See, American Broadcasting Companies, Inc. v. FCC, 663 F.2d 133, 138 (DC Cir. 1980). As Mr. Brand points out, the basic benefits of convenience

and quality and the cost of access to the data center of DirectNET do not differ materially from the benefits of Mailing Online. Therefore, "from a customer's viewpoint", the technological distinctions Mr. Garvey seeks to draw are "immaterial" (Rebuttal Testimony at 3/L11-13). Witness Garvey's claim that Mailing Online and DirectNET differ fundamentally cannot be credited as a factual or legal matter.

Mr. Garvey also asserted that "nothing would stop" Pitney Bowes from passing through the first class and Standard (A) automation, and Standard (A) drop entry discounts to DirectNET users if Pitney Bowes "commingled different customers' mail" and was "able to solicit enough customers" to achieve the volume and point of entry requirements of the existing discount eligibility standards. Tr.2/371. This is not responsive: "at least during the market test" (Tr.2/371) the discounts will be made available to Mailing Online users whether or not their mail qualifies for them. DirectNET customers should be treated the same.

In short, the Postal Service has set one standard for its competition, and another, considerably more relaxed standard, for itself. Section 3623(c)(1) was intended to guard against precisely this kind of unfair competition. The remedy to this competitive imbalance is equally clear cut. The Commission should condition any favorable approval of the market test upon a requirement that the Postal Service make special Mailing Online discount eligibility rules equally available to DirectNET and other functionally equivalent services. We append to this Brief (as Exhibit A) suggested DMCS language to accomplish that result.

The Commission is, at present, adjudicating only the market test proposal.^{2/} But, even during the market test, the Postal Service should not be permitted to confer upon itself an unfair competitive advantage. This is best avoided by requiring that Mailing Online postage discounts be made available to providers of functionally equivalent service like DirectNET. See, ECOM Decision at 167.

II. The Postal Service Should be Required to Conduct a Fresh Market Survey During the Market Test.

The volume estimate concerning the Mailing Online Service are based entirely on the survey results sponsored by Witness Rothchild. The Postal Service concedes that no better information concerning consumer response to the surveys is likely to be developed during the market test period because of the anticipated brevity of that test and its constrained geographical reach. Obviously this Commission needs to have good estimations of Mailing Online volumes if it is to perform realistic evaluations of the revenues (and, consequently, cost coverages) that the service will yield.

It is entirely proper to rely on a solidly grounded survey evidence to project volumes when no better information is available. But the Rothchild sponsored volume evidence is not solidly grounded. It was developed before the initial printing contract for Mailing Online was entered into. It was based on price

^{2/} For this reason, we refrain from addressing in this brief the other competitive issues raised by the Mailing Online proposals. Issues such as the adequacy and fairness of the proposed cost coverage (See, e.g., Tr.2/683) are best dealt with in the hearings on the experimental proposal.

points that are very different from those that the Postal Service will actually achieve under the initial printing contract for Mailing Online services. For example, the total postage and fee for a ten page, 8.5 x 14 duplex black and white piece is \$1.6013. OCA/USPS-T5-28 at Exhibit A example 2. The price on which survey results were based was \$1.19. Notice of United States Postal Service of the Filing of Errata to Library Reference USPS-LR-2/MC98-1 at 4 (25% cont) (the "LR-2 Errata"). The contract price for a five page, 8.5 x 11 simplex spot color piece mailed as Standard (A) is \$.50, OCA/USPS-T5-28 at Exhibit A example 3, but the survey price point is \$.71.^{3/} LR-2 Errata at 4 (25% cont.).

Plainly, better survey information is necessary to repose confidence in volume projections drawn from a survey. Witness Garvey freely conceded that

"... If we were to do the survey the National Analysts did again using [the actual] contract prices, we would come up with some different results, that is true."

Tr.2/366.

3/ The survey may have been somewhat confusing in its gauge of Standard (A) mail volumes in that the price points refer to "next-day delivery" and "Standard (2-to-5-day) delivery rather than First Class and Standard (A) mail. The same potentially misleading descriptions are also contained in the class-specific inquiry concerning volume in question 7. The pamphlet distributed to survey participants to familiarize them with the proposed service aids in this confusion. It says:

" - 95% of domestic pieces could be delivered the day after transmission
 - A Standard delivery option, with delivery in two to five days, would also be available."

LR-2 Errata at page 2.

Despite all of this, when asked whether the Postal Service contemplates doing the National Analysts survey again, the witness said, "No." Tr.2/366/L21. No convincing explanation for this position has been offered. The Postal Service has not -- and apparently cannot -- claim that it will take more than three months (the time it has allotted for the market test) to conduct a new market survey. Tr.2/367. Nor has it explained why a new survey would take as long to complete as the original survey might have.

Accurate volume projections are an essential piece of "information that could shed light" on the prospects of a potential service innovation such as Mailing Online. Notice of Proposed Rulemaking in Docket RM95-4, 60 Fed. Reg. 54981 (October 27, 1995) ("NPRM"). Market surveys based upon actual contract prices (now that they are available) will yield more reliable forecasts of volumes than the volumes projected on the price points that Ms. Rothchild used. Yet, the Postal Service rejects a fresh survey. It proposes instead to "augment" the Rothchild volume estimates -- which it concedes to be inaccurate -- with actual volume experienced during the market test, which will be fragmentary, at best. See, USPS-T-1 at Appendix A; Tr.2/332.

This simply will not do. Unless the Commission requires the Postal Service, as a condition of launching the market test, to perform a new market survey, one of the core purposes of the market test rules will be defeated. An essential piece of information that will "shed light" on the Mailing Online prospects will be unavailable. NPRM, 60 Fed. Reg. at 54981. In order to preserve the integrity of the market test rules, the Commission must condition

any approval of the market test on requirements that the Postal Service conduct a new market survey of the type presented by witness Rothchild and that the new survey be completed in time for submission and examination in the hearings on the experimental proposal.^{4/}

III. With Minor Changes, the OCA's Data Collection Plan Should be Adopted.

The OCA's proposed data collection plan (Motion of OCA filed August 18, 1998), is both reasonable and properly related to the purposes of the market test rules.^{5/} Only certain aspects of the dispute between the Postal Service and the OCA over the OCA's proposal warrant comment.

A. Advertising Expenses. The Postal Service intends to promote Post Office Online (including Mailing Online) through the mass media. It nonetheless resists the OCA's proposal that advertising, promotional and educational expenses be reported. Postal Service Response to OCA Motion at 7 ("Postal Service Response"). It asserts that, because there will be "no advertising or promotion specific to Mailing Online" the costs associated with advertising are therefore "institutional" and hence irrelevant to the cost of providing Mailing

^{4/} The survey could, and probably should, be simplified by deleting the portions of it designed to elicit responses to enhanced services that may well not be a part of any experiment approved by the Commission. The Postal Service has indicated that it will do some polling during the market test concerning the response to enhanced services (Tr.2/312); that effort should be kept separate from a more rigorous gauge of likely volumes for the service that will actually be offered.

^{5/} Pitney Bowes believes that the disagreement between the Postal Service and the OCA as to the timing of submissions can be accommodated, as discussed below.

Online. Postal Service Response at 7. It bases this claim on the fact that Post Office Online is a multi-component "service", two pieces of which are perceived by the Postal Service to involve non-postal products and only one of which -- Mailing Online itself -- is conceded to involve a "postal service" within the jurisdiction of this Commission.

This does not justify the refusal to report the information. It is true that the Commission has never addressed the question of how advertising and marketing costs for a service of this type should be allocated and recovered. It is also plain that the proper allocation of advertising expenses has both cost recovery and competitive implications. The Postal Service should not be permitted to moot an issue likely to be contested in the next phase of this case by its refusal to provide information relevant to its resolution. The OCA's proposal that advertising promotion and educational expenses be reported should be adopted at the level of detail the OCA has specified.

B. Processing Center, Telecommunications and Print Site Expenditures. The issue here is identical to that presented by the Postal Service's refusal to supply information concerning advertising, promotion and educational expenses. In its Response to the OCA Motion, the Postal Service asserts that only some of these costs "bear on Mailing Online," that others, such as Web server costs, "will be incurred regardless of the status of Mailing Online" (Postal Service Response at 6) and that such common costs need not be reported. This, too, prejudices an issue that will have to be decided in the litigation on the experimental phase. That certain costs may be incurred without

regard to Mailing Online simply does not alter the fact that the total of costs incurred constitute joint and common costs to the extent that these facilities are actually used for Mailing Online purposes; some allocation between regulated and unregulated uses may be required. ECOM Decision at 167-168. Thus, the total of costs as well as the extent of usage is precisely the sort of "real world" (NPRM at 54981) information that should be collected and reported during the market test phase as the OCA proposes.

C. Mailing Verification Information. Under the procedures contemplated by the Postal Service, mailing statements will be generated by the Postal Service itself, will be transmitted to the printer who will not be permitted to change them and then will be presented to the mail acceptance clerk, along with the associated Mailing Online mailing. Tr.2/351-53, see also Tr.2/232 and Further Responses of Witness Garvey to Concerns Raised During Oral Cross-Examination (filed August 28, 1998). The Postal Service insists that, except as to the special rules of discount eligibility, the contractor is required to fully comply with the DMM and that mail acceptance clerks will review and verify each Mailing Online mailing statement as they do with other mailings. Tr.2/353. But the data collection system the Postal Service proposes provides no means to confirm or refute this claim.

This raises both competitive and consumer protection concerns. Among other things, if the Postal Service's self-generated mailing statement undercounts the volume actually delivered to the mail acceptance clerk, Mailing Online service will have been artificially and improperly made more attractive

than any other form of mail entry: no third party mail entry provider (including Pitney Bowes through DirectNET) is permitted to self verify its mailing statements. Conversely, if the Postal Service's self-generated postal statements over count volumes, users are being treated unfairly because postage payment is to be made in advance on the basis of the Postal Service's self-generated mailing statement, not on the mail count actually delivered to the mail acceptance clerk. Information concerning how Mailing Online mailings are actually presented for delivery is thus imperative.

There is a simple solution to this problem. As Pitney Bowes understands it, acceptance clerks do (and may be required to) maintain a Mailer Notification Log for Disqualified Mailings (PS Form 8075). This form shows, among other things, the reason for disqualification and the disposition of a disqualified mailing. The Postal Service should be required to maintain a separate log for Mailing Online mailings and to submit these logs as a part of its report during the Market Test.^{6/}

D. Mailpiece and Usage Characteristic Data. If we understand the Postal Service's position correctly, it does not object to most of the mailpiece and

^{6/} We have proposed confining the reporting requirement to the Disqualified Mailing Log to avoid undue burden on the Postal Service, parties and the Commission. Further information -- including the mailing statements themselves -- can be obtained through discovery, if needed. Although the Postal Service customarily treats mailing statements as nondisclosable under the Freedom of Information Act, we assume that position will not be taken here. The Mailing Online mailing statements will all be entered in the name of the Postal Service and, therefore, disclosure through discovery will not expose commercially sensitive information.

usage characteristic information the OCA has specified to be included in the data collection plan.^{7/} It apparently intends to satisfy this reporting obligation principally through the "system reports" prepared by Price Waterhouse from data which is generated by the Mailing Online system automatically. Tr.2/289. The problem is that the reports, at least in the form submitted as a Library Reference, are riddled with anomalies and inconsistencies. The Postal Service witness candidly acknowledged that he "can't explain" these problems. Tr.2/359. We assume that the Postal Service will undertake, on its own initiative, to try to resolve these anomalies so that they do not recur in the reports submitted during the market test. In any case, we do not think it unreasonable for the Commission to direct that the raw data for each of these reports be preserved so that, to the extent necessary, any anomalies that continue to occur can be subjected to scrutiny through discovery.

E. Timing of Report Submissions. The Postal Service's complaint that the OCA's insistence on weekly reports for all information is unduly burdensome may not be entirely unfounded. However, its alternative solution -- that most information be reported on an accounting period basis -- is as inappropriate as its original quarterly reporting plan. The Mailing Online market test is scheduled to operate on a calendar basis for three months and ten days; that operational period bears no relationship to the accounting period dates. The result is that

^{7/} We do not understand the Postal Service's refusal to provide information as to the number of users per day. That information would be discoverable in any event.

aggregation of information on an accounting period basis will simply lead to confusion and protracted discovery in the next phase of the litigation.

It seems to Pitney Bowes, however, that there is a way to accommodate these considerations without either unduly burdening the Postal Service or depriving the Commission and parties of the timely receipt of information. To the extent that the Postal Service has agreed to provide information on a weekly basis, it should be required to do so. All other information (with the exception of cost data) should be reported every ten working days; this roughly, albeit somewhat generously, corresponds to the discovery response practice the Commission has followed in this and recent cases. Because ten days worth of cost information is not likely to prove meaningful in any event, the Postal Service should be required to report cost information on a calendar month basis, not later than seven days after the conclusion of the calendar month.

CONCLUSION

For these reasons, Pitney Bowes respectfully maintains that, if the Commission determines to recommend the initiation of a market test with respect to the Postal Service's proposed Mailing Online service, it should make its recommendation contingent upon (i) a requirement that the Postal Service make available these special Mailing Online postage discounts to DirectNET and other functionally equivalent services, (ii) a requirement that the Postal Service conduct a new market survey using actual contract printer prices, and (iii) a

requirement that the Postal Service adopt and carry out a data collection plan which incorporates the proposals advanced by the OCA in its Motion and by Pitney Bowes in this Brief.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "I. D. Volner", is written over a horizontal line.

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September 18, 1998

EXHIBIT A**FIRST-CLASS MAIL
CLASSIFICATION SCHEDULE**

- 221.31 a. Is (i) prepared in a mailing of at least 500 pieces, (ii) is provided for entry using Mailing Online service, pursuant to Schedule SS-7, or (iii) is presented for entry using a hybrid electronic postal service offered by a third party service provider.


**STANDARD MAIL
CLASSIFICATION SCHEDULE**

- 321.231 a. Is (i) prepared in a mailing of at least 200 addressed pieces or 50 pounds of addressed pieces, (ii) is provided for entry using Mailing Online service, pursuant to Schedule SS-7, or (iii) is presented for entry using a hybrid electronic postal service offered by a third party service provider.
- 321.24 **Destination Entry Discounts.** The destination entry discounts apply to Regular subclass mail prepared as specified by the Postal Service and addressed for delivery within the service area of the BMC (or auxiliary); service facility, or sectional center facility (SCF), at which it is entered, as defined by the Postal Service. The destination BMC discount also applies to Regular subclass mail provided for entry using Mailing Online service, pursuant to Schedule SS-7 and regular subclass mail that is presented for entry using a hybrid electronic postal service offered by a third party service provider.

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CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing document upon the United States Postal Service in this proceeding in accordance with sections 12 and 20(c) of the rules of practice.



Ian D. Volner