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MAILING ONLINE SERVICE

Docket No. MC98-1

REPLY BRIEF OF UNITED STATES POSTAL SERVICE
REGARDING MAILING ONLINE MARKET TEST

Daniel J. Foucheaux, Jr.
Chief Counsel, Ratemaking

Kenneth N. Hollies
Scott L. Reiter
David H. Rubin

475 L'Enfant Plaza West, S.W.
Washington, D.C. 20260-1137
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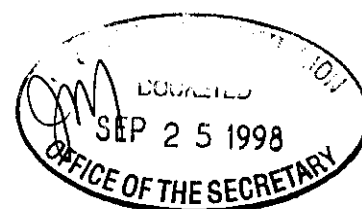


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I. Initial Briefs

Only three other parties in this proceeding filed initial briefs: Pitney Bowes, Mail Advertising Service Association International (MASA), and the Office of the Consumer Advocate (OCA). Only MASA opposes the Commission's recommendation of the Mailing Online market test. The three parties raise several issues which are worthy of further discussion in helping the Commission to evaluate the record and recommend the Postal Service's proposal.

II. The Mailing Online Proposal Fosters Competition

Both Pitney Bowes and MASA argue that the Commission needs to consider the competitive impact of Mailing Online. PB Brief at 2-6; MASA Brief at 4-8. The Postal Service believes that the Commission can recommend a market test of Mailing Online without creating any adverse impact on competition. Mailing Online is designed to meet needs of smaller customers that are not being met well today, in ways that would not harm private firms. See Postal Service Initial Brief at 16-19. The record shows that Mailing Online may increase the overall market for hybrid electronic postal services and lettershops. USPS-T-1, at 12-14; Tr. 2/151. Thus, competition can be expected to thrive as the market expands.

Pitney Bowes misstates the law when it asserts that the relevant focus for the Commission is the effect of a proposed service "upon private sector competitors." Even insofar as the Postal Reorganization Act points to competitive impact as a relevant consideration in the Commission's review, 39 U.S.C. § 3622(b)(4), the appropriate standard was set forth by the Court of Appeals in 1985: "[I]t must be remembered that the PRC's task is to protect *competition*, not particular competitors." *Direct Marketing*

Association, Inc. v. United States Postal Service, 778 F.2d 96, 106 (2d Cir. 1985)

(emphasis in original; citation omitted). Put in this context, the record clearly shows that Mailing Online will have minimal effect upon particular competitors and will foster competition overall.

In proposing Mailing Online, the Postal Service is not seeking to “engage in activities traditionally performed by the private sector,” contrary to the assertions of Pitney Bowes and MASA. PB Brief at 3; MASA Brief at 6. All printing and finishing services will be provided by private contractors. The integration function that the Postal Service fills cannot be described as traditionally performed by any entity or group. As witness Garvey testifies, while other services may attempt to integrate electronic data transmission and hard copy document production, the similarities end there. See Postal Service Initial Brief at 18-19. Pitney Bowes presents no evidence stating that DirectNET merges customer files to achieve greater densities or that it does more than simply convert documents from electronic to hard copy form. See Tr. 4/829.

Pitney Bowes and MASA both rely on the Commission’s language in the E-COM cases indicating that the Commission should consider competition as part of its mandate to evaluate the effect of a Postal Service proposal on the public interest, and that this amounts to an inquiry into fairness and efficiency. PB Brief at 2; MASA Brief at 6. Again, the issue is the effect on competition, not on particular competitors. Mailing Online was specifically designed, in contrast to E-COM, so that the Postal Service would *not* be entering into activities performed by the private sector. The Postal Service is not entering into the printing or telecommunications businesses; instead, it is

relying on private printers, who can participate by competing for contracts, and on existing telecommunications infrastructure in the form of the internet.¹

Finally, the Commission is currently considering only the market test proposal for Mailing Online. The Mailing Online market test, limited in scope and duration as proposed, should have exceptionally little impact. The OCA agrees that this is so. OCA Brief at 1. Pitney Bowes implicitly agrees by stating that it is deferring its discussion of competitive issues to the experimental phase of the case. PB Brief at 6 & n. 1.

III. The Proposal to Make All Mailing Online Volume Subject to the Basic Presort Rates Does Not Discriminate Against Private Sector Providers of Mail Preparation Services

In designing Mailing Online to meet the needs of small customers, the Postal Service plans to merge documents from different customers in order to achieve greater densities than would otherwise have been possible. In order to charge customers at the time they submit their jobs, a postage rate must be quoted before the batching is completed and the actual presort level is known. The Postal Service therefore proposes to offer an average price to customers based on the characteristics of the

¹ Unlike the circumstances that triggered concern in the Provisional Packaging Service case, the Postal Service is proposing to enter a market serving small mailers not currently served by the private sector. See PRC Op., MC97-5, Dissenting Opinion of Commissioner LeBlanc at 1. As in that case, moreover, there is "insufficient evidence to justify a conclusion that the probable impact of introducing" Mailing Online on the private sector "is likely to be undue, unreasonable or unnecessary." PRC Op., MC97-5, at 41. It should be noted, moreover, that the rules for provisional services specifically require examination of whether a proposal causes "unnecessary or unreasonable harm to competitors of the Postal Service." Rule 171(a).

merged document stream.² One presort category, Basic, would apply for all mail prepared using Mailing Online. USPS-T-5 at 10-11. In theory, some Mailing Online mailing statements may show less than the usual minimums for Basic, while others will likely show higher levels of presort than Basic. *Id.* at 11-12; Tr. 2/158. Hence, in order to have the Basic categories apply to all Mailing Online volume, thus permitting customers to know actual postage when jobs are submitted, exceptions to the minimums are necessary for Mailing Online documents.³

Pitney Bowes and MASA criticize the proposal by focusing only on the exceptions to the minimums without addressing the simultaneous foreclosure from deeper discounts. Pitney Bowes argues that, in order to prevent unfair competition, the exceptions should be extended to "any functionally equivalent and competitive service, including Pitney Bowes' DirectNET." PB Brief at 1. Similarly, MASA argues that the Postal Service's proposal for Mailing Online would "make lower rates available to MOL users than are available to the customers of private businesses that offer the same services." MASA Brief at 6. These criticisms miss the mark.

A. The Average Postage Rate Proposed by the Postal Service Will Be Higher than Some Rates Available to the Private Sector

Because the Postal Service is applying one average rate to all Mailing Online volume, private services are not being disadvantaged. In fact, the Postal Service's

² The selection of the postage rate for Mailing Online will be tested during the experiment, so the postage rate might be adjusted for any subsequent filing for a permanent Mailing Online service.

³ Request, Attachment A1, at 1, as revised August 5, 1998; Attachment B1, at 1, as revised August 5, 1998.

proposal minimizes the potential impact on the private sector by, in effect, ceding deeper discounts to lettershops and services like DirectNET. Pitney Bowes and MASA ignore the availability of the lower 3-digit, 5-digit, 3/5-digit, and carrier route rate categories for their customers, which are unavailable for Mailing Online. Furthermore, the Mailing Online exceptions would be a comparative advantage only to the extent that lettershops and DirectNET enter most of their mail at single-piece rates. No record evidence supports such an unlikely assertion.

By limiting Mailing Online to the basic presort rates, the Postal Service would actually be at a competitive disadvantage in trying to attract large volume customers. Pitney Bowes seeks both to retain that advantage and to gain a lower rate for any low-volume customers it serves.

Specifically, in Exhibit A to its Brief, Pitney Bowes presents proposed changes to the requested DMCS language that would make the automation rates and the Standard Mail destination BMC discount available for "a hybrid electronic postal service offered by a third party service party" to the same extent as for Mailing Online. These sections are unclear in that "hybrid electronic postal service" is undefined. Moreover, they provide unfairly preferential treatment for any hybrid electronic postal service, compared to Mailing Online. DMCS section SS-7.021, as proposed by the Postal Service, limits mail created using Mailing Online to the basic presort rate categories, even if that mail is presorted enough to qualify for a lower rate.⁴ Pitney Bowes' proposal provides no

⁴ DMCS sections 221.31 and 321.231 could perhaps be clarified, much like the clarifications to notes 3 and 8 of rate schedule 221 filed by the Postal Service on August 5, 1998, that limited the exception from the volume minimum to the Basic
(continued...)

such limit for DirectNET, giving itself an advantage over the Postal Service. If Pitney Bowes wishes to enjoy the same alleged advantage of Mailing Online that it proposes, fairness dictates that the same limits should apply as well. However, given that DirectNET currently enters mail at lower rates than the automation basic rate category, Tr. 4/889, treating DirectNET the same as Mailing Online may not be what Pitney Bowes actually desires.

B. The Record Does Not Show that Mailing Online Has Functionally Equivalent Alternatives which Deserve the Same Rate Treatment

Pitney Bowes' proposed DMCS language reflects the judgment that DirectNET is the functional equivalent of Mailing Online. However, while the record has not been fully developed concerning DirectNET, it appears to have characteristics that differ from Mailing Online's. One major difference is that DirectNET apparently does not batch jobs together to achieve higher levels of presort than those the customers themselves would achieve.⁵ There is no reason to extend the Mailing Online postage rate design to "hybrid electronic postal services" that do not merge jobs together. For these services, the proper postage rate can be determined at the time a job is submitted by a customer.

In addition, DirectNET's customer interface and software, as well as the means by which mail is entered, need to be compared with Mailing Online's on the record as this

(...continued)

Presort rate, in keeping with proposed DMCS section SS-7.021. The additional text for sections 221.31 and 321.231 thus could read ", or is provided, for the Basic Presort rate, for entry using Mailing Online service, pursuant to schedule SS-7." Such a clarification is probably not necessary, however, since schedule SS-7 already clearly provides that Mailing Online mail is eligible only for the Basic Presort rates.

⁵ Witness Garvey's testimony that no existing hybrid services do such batching stands un rebutted. Tr. 4/829.

proceeding moves forward.⁶ Unless "hybrid electronic postal services" are determined to be equivalent to Mailing Online, the rate design for Mailing Online should not be applied to different private alternatives.

IV. There Is No Need for New Market Research

Pitney Bowes argues that the Postal Service should be required to conduct a "fresh" market survey during the market test and that the Commission must 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." Pitney Bowes Brief at 6.⁷ While volume estimates may ultimately be required to evaluate a request for

⁶ For example, the extent to which Pitney Bowes and the Postal Service would be accountable for the mailing statements used to enter the Mailing Online or DirectNET mail needs to be compared.

⁷ Pitney Bowes argues that "[a]ccurate volume projections are an essential piece of 'information that could shed light' on the prospects of a potential service innovation such as Mailing Online," citing the Commission's Notice of Proposed Rulemaking in Docket No. RM95-4, 60 Fed. Reg. 54981 (1995). Pitney Bowes Brief at 8. While the phrase "information that could shed light" clearly appears on the cited page, it is in a context which, rather than supporting Pitney Bowes' implicit assertion that market research is required in support of a request for an experimental service, instead contradicts it:

While one commenter, United Parcel Service, disputes the necessity of adopting a market test rule, the Joint Task Force Report correctly observes that *there is no "well-worn path" in Commission procedure for obtaining information that could shed light on the prospects of potential service innovations through limited testing in the marketplace.*

60 Fed. Reg. 54981 (emphases added).

a permanent service, there is no requirement for volume estimates to be produced during the market test to inform evaluation of the request for experimental service.⁸

The market test is not designed or intended to produce projectible estimates of national volume for the simple reason that this is one of the goals of an experiment. Thus, it is of no significance that, as Pitney Bowes states at page 6 of its brief, no further volume information will be developed in the course of the *market test*. Superior volume estimates are expected to be produced as a part of the *experiment*.

The Commission has consistently interpreted the rules for experimental services to contemplate waiver of the usual rules that require provision of volume estimates for the very reason that collecting such information is one of the reasons for conducting an experiment. In the first experimental case, the Commission stated: "The essence of a market experiment is to ascertain whether potential customers will purchase a service not currently available to them." PRC Op., MC86-1, at 41. The Commission noted that "[c]hoosing to test market a new service without extensive preliminary market surveys can be a rational management decision." *Id.* at 42.⁹

⁸ It should be remembered that a market survey was included with the request in this case because the Postal Service had commissioned it for business purposes and then found it would be useful in formulating its request to the Commission. Simply because the Postal Service provided more information than strictly required by the rules should not obligate it to do even more market research when, as discussed below, the procedures being followed here provide better ways to project Mailing Online volumes. It cannot be denied that the Postal Service has already estimated volumes for the experiment based upon the best information available, at the time of filing, thus meeting its obligations under the statute and the Commission's rules.

⁹ In that case, the Postal Service indicated its intention to conduct a market survey during the course of the experiment, because it was not expected that the experiment would generate the information needed to project volumes. *Id.* at 78.

In Docket No. MC96-1, the Commission indicated its belief that market research or other assessment of mailers' interest in the proposed service should be a subject of data collection during the course of the experiment. PRC Op., MC96-1, at 28. In Docket No. MC97-1, the Commission noted that additional market research would be conducted in tandem with the collection of other data. PRC Op., MC97-1, at 20.

Accordingly, it can be seen that, in each experimental case, volume data are developed as appropriate to the circumstances of the service. In this case, it is expected that as the experimental service progresses and as Mailing Online is made available in more locations via a national network of printers, it will be possible to base volume projections on actual Mailing Online usage. Projections based upon measures of actual behavior tend to be inherently more accurate than ones based on statements regarding intended behavior, which, no matter how well designed and conducted, is all market research can produce. Thus, attempting to reprise the survey during the market test is unnecessary and less effective than allowing the experiment to collect volume and other data.

In addition, quantitative market research is both time-consuming and expensive. The survey would not be able to be repeated during the period of the market test. Tr. 2/367. Indeed, in the abstract a new survey would be expected to take five months, less time than the original survey took; however, given the convergence of the market test period and the holiday season, additional time would have to be allowed. Thus, further survey results could not be expected until long after the market test was concluded. Moreover, quantitative market research of the quality needed to withstand scrutiny in these proceedings is also quite expensive. The Postal Service believes that

there is no need for such an expenditure since the experiment itself will produce better information.¹⁰

Pitney Bowes argues that the Commission needs new volume data to estimate cost coverages. Pitney Bowes Brief at 6. Since the proposed fees are based almost entirely on actual printer costs, there is no need for volume information to calculate the cost coverage of fees above those costs. Volume estimates are only needed for the non-printer costs, whose magnitude in relation to printer costs is so small that they have no significant effect on the cost coverage. See Postal Service Initial Brief at 8-9.

Pitney Bowes notes that some of the prices in the actual printer contract are different from those tested in the market survey. Pitney Bowes Brief at 6-7. Since witness Plunkett points out that this contract is "a specific contract in what is generally considered to be a high-cost area," Tr. 2/666, it should not be surprising that prices found in the contract are different from those selected in an earlier time period to be representative of a national average. There is accordingly no basis for concluding that the contract prices are more indicative of a national average than those used in the market research.

V. The Data Collection Plan Formulated by the Postal Service Will Provide More than Sufficient Information

¹⁰ No matter how much money or time the Postal Service spends on quantitative market research, it can always be subject to criticism like Pitney Bowes' here, that it is not "solidly grounded" (Pitney Bowes Brief at 6), simply because time has passed and proposed prices or other variables have changed. Indeed the more solidly grounded the survey is, the more likely it is to have taken a good deal of time to design and conduct and therefore the more likely it is that something will have changed since the survey was designed and conducted. This is another reason why actual results from the experiment will be superior to new survey results.

Details of the market test data collection plan were addressed in testimony (USPS-T-1) and in an OCA motion and Postal Service response, all of which the Postal Service covered in its initial brief, especially in section X starting at page 21. Arguments in the Pitney Bowes and MASA briefs concerning data collection have also largely been covered in the Postal Service initial brief. The totality of the OCA's initial brief focuses on data collection, and while its effort is quite comprehensive, the OCA's approach is virtually unbounded by any realistic consideration of cost, difficulty of collection, or utility. Most of its points have already been addressed, but further comments are presented below.

The Postal Service data collection focus during the market test will be on collecting mailpiece information as described in USPS-T-1, Appendix A (modified by the OCA's suggestion to include finishing characteristics). Mailpiece information will continue to be derived from reports generated by the Mailing Online server.¹¹ The following demand data elements can be reported weekly during the market test: total transactions; total revenue; total pages; volume by simplex or duplex; volume by color vs. black and white; volume by page size; volume and revenue by subclass; volume by shape; volume by finishing characteristics; and operational statistics. The Postal Service can report on a weekly basis the number of daily users and transactions.

¹¹ Implicit in Pitney Bowes witness Brand's claim that DirectNET is comparable in some respects to Mailing Online is the necessity for filing all information collected under protective conditions. As will be shown during the experimental phase of litigation, DirectNET's Web presence is not comparable (yet) to that of Mailing Online, but Pitney Bowes is moving its service in the direction of Mailing Online. Accordingly, and in keeping with usual Commission practice, individuals should be permitted access to reported information only to the extent they are wholly uninvolved in development of hybrid products.

Printer site logs will be kept of dates of receipt and entry of mailings. These will be annotated to reference expected date of mailing and can be provided on a bi-weekly basis.

No data on cost avoidance will be collected from within plants. See OCA Brief at 17. The essence of Mailing Online is unique processing of electronic material, which is subsequently rendered into physical mail that is processed entirely in accordance with the existing mail processing environment. See Tr. 2/191-96. No Mailing Online fee is based on post-entry processing. Hence, there is absolutely no basis for involving Mailing Online data collection in details of post-entry processing. To the extent necessary, judgments regarding the appropriate rate categories for Mailing Online can be based on mailpiece characteristics data and other aggregated information regarding the pre-mail processing of Mailing Online, together with existing information regarding mailpiece characteristics of specific rate categories.

Copies of physical mailing statements could be provided bi-weekly. The software modifications necessary to save and provide electronic copies cannot be accomplished easily or quickly, and thus may be a possibility for the experiment. See Tr. 4/885.

With respect to customer opinions and preferences, the Postal Service will evaluate the help desk information for customer reactions and opinions and can report such consolidated information on a bi-weekly basis. Certain customer survey results can also be reported to the Commission where appropriate to experimental service projections. These will include the edited results from voluntary questionnaires

requesting information about the customer's use of specific types of mailing applications, the number of employees and the type of business.¹²

Resource and cost reporting will be performed for information systems, telecommunications and help desk functions where resource usage is representative of the experimental period. Logs will be maintained of activities specific to Mailing Online where it is possible and appropriate to differentiate and segregate them. These can be reported on a bi-weekly basis.

For the customer help desk the Postal Service can report the number of help desk calls received specifically relating to Mailing Online, the percentage of total PostOffice Online calls this number represents, and a general categorization of the reason for the calls. Information regarding length of calls, however, would be very difficult to collect and costly to compile; we would find reporting of this information during the market test to be overly burdensome.

For information systems, logs will be maintained of activities performed in support of Mailing Online systems at the print site locations and the postal data processing center. Actual costs incurred for information systems expenditures can be reported on an accounting period (AP) basis.¹³ Telecommunications costs for print site data transmissions also can be reported.

¹² The Postal Service is in the process of putting together a voluntary questionnaire which PostOffice Online customers would be afforded an opportunity to fill out when registering. Consideration is being given to including questions regarding the purposes for which Mailing Online would be used.

¹³ This information is available directly from accounting period reports.

The OCA's expectation that actual information can or will overtake all of witness Stirewalt's assumptions (OCA Initial Brief at 24 and Appendix A), however, is unfounded and misplaced.¹⁴ As a simple example, Mailing Online personnel are currently unaware of whether or how a byte-tracking system could be developed (although this can be researched further). Instead, byte counts are estimated from job characteristics. Similarly, the Web tool that can track average session duration and peak usage will not be available until the experiment at the earliest because of the significant developmental work necessary to put it into place. It may be that some of the information the OCA believes is necessary (even if identified for the first time only on brief) can be collected and reported during the experiment. Other information the OCA seeks, such as total number of users, is inherent in the mailpiece characteristics data the Postal Service already plans to provide.

In its initial brief, at 26, the OCA claims the "Postal Service confuses the data needs of classification cases with those of rate cases." However, it is the OCA who is confused about the data needs of a classification case. The decision to launch a new product requires a comparison of the costs that are estimated to be incurred in

¹⁴ The Postal Service believes the ongoing operations test is too idiosyncratic to provide data (such as the proportions of mail merge and non-mail-merge jobs) that would be valid to change witness Stirewalt's assumptions. Tr. 2/195; *see also* USPS-LR-6/MC98-1 (total of 83 jobs over approximately four months — a sample likely too small to permit accurate projection). Moreover, many of the OCA's concerns about witness Stirewalt's results appear unfounded. Thus, the data storage needs for mail and non-mail merge jobs are correctly calculated by witness Stirewalt. All witness Stirewalt acknowledged at the hearing was a labeling error: "It's an error in the heading." Tr. 3/773, line 5. Moreover, the fact that certain assumptions may not be based on hard empirical data does not undercut the fact that they are the judgment of a seasoned professional, using accepted information systems practices; his assumptions are well reasoned and sound. *See, e.g.*, Tr. 3/746-47.

providing the new product with its expected revenues. That does not include costs which would be incurred regardless of the existence of the new product. In particular, costs that are fixed and common to projects other than Mailing Online, such as advertising costs for PostOffice Online, would be incurred regardless of whether Mailing Online goes forward and should therefore not be borne by Mailing Online. See Tr. 4/881. The only fixed costs that arguably should be included are those specific to Mailing Online. The only common costs that arguably should be included would be the fraction of the common costs that would be avoided if Mailing Online were not offered. In this regard, it is inappropriate for the Postal Service to provide information on costs that are not part of the attributable costs of the product.

The costs presented in testimony permit the Commission to conclude that attributable costs are covered, incremental cost tests are satisfied, and that expectations of cost recovery are reasonable. There is no basis for any conclusion that traditional cost attribution principles should be modified for Mailing Online. The fully distributed costing approach advocated by the OCA, moreover, is inappropriate. By the OCA's logic, costs traditionally considered institutional, such as the OCA's own costs of operation, those of the Commission, and those of Postal Service litigating staff should all be attributed to small experiments. This would violate established costing principles and create an unwarranted entry barrier to the establishment of new services. Nevertheless, the appropriate use of piggyback factors could be a topic for consideration in the experimental phase.

Starting at page 31 of its initial brief, the OCA argues that printer performance should be monitored closely and reported. Since only one printer is now scheduled to

participate in the market test, and since a purpose of the market test is to make sure that the Postal Service's assumptions embodied in the printer contract are fair and reasonable, the Postal Service submits that reporting on printer performance is not warranted during the market test. Problems identified in the market test would be corrected before the experiment, and thus would not be relevant to a decision on the experiment.

MASA argues that the market test should be rejected because the Postal Service does not expect to change the classification language based on market test results. MASA Brief at 2. But the purpose of a market test is to provide information to inform the Commission's consideration of an associated permanent (or in this case experimental) proposal, not whether the market test will trigger a Governors' determination to change or withdraw the request already filed. With regard to the proposal for a Mailing Online experiment, the Commission must fashion a recommendation that takes into consideration the pricing structure, markup, fees, cost coverage, and experimental data collection plan, all of which could be further informed by data collected during the market test. Data that the Postal Service has agreed to provide will fully inform the Commission's consideration of these issues during the experimental phase of this case.

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WHEREFORE, the Commission should recommend the market test as proposed by the Postal Service.

Respectfully submitted,
UNITED STATES POSTAL SERVICE
By its attorneys:

Daniel J. Foucheaux, Jr.
Chief Counsel, Ratemaking


Kenneth N. Hollies

Scott L. Reiter
David H. Rubin

CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing document upon all participants of record in this proceeding in accordance with section 12 of the Rules of Practice.


Kenneth N. Hollies

475 L'Enfant Plaza West, S.W.
Washington, D.C. 20260-1137
(202) 268-3083
Fax: (202) 268-5402
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