

ORIGINAL

BEFORE THE  
POSTAL RATE COMMISSION  
WASHINGTON, D.C. 20268-0001

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MAILING SERVICE  
OFFICE OF THE SECRETARY

Mailing Online Service

Docket No. MC98-1

RESPONSE OF MAIL ADVERTISING SERVICE ASSOCIATION  
INTERNATIONAL/PITNEY BOWES  
WITNESS PRESCOTT TO INTERROGATORIES OF  
THE UNITED STATES POSTAL SERVICE  
(USPS/MASAPB-T1-21-27)

The Mail Advertising Service Association International/Pitney Bowes hereby provides the responses of Witness Prescott to the following interrogatories of the United States Postal Service: USPS/MASAPB-T1-21-26, filed on February 23, 1999 and USPS/MASAPB-T1-27, filed on February 25, 1999.

Each interrogatory is stated verbatim and is followed by the response.

Respectfully submitted,

By its attorneys:

  
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**RESPONSE OF MAIL ADVERTISING SERVICE ASSOCIATION  
INTERNATIONAL/PITNEY BOWES  
WITNESS PRESCOTT TO INTERROGATORIES  
OF THE UNITED STATES POSTAL SERVICE**

USPS/MASAPB-T1-21. Please refer to your testimony at page 15, lines 12 to 13.

- (a) Do you understand the Postal Service plans to be limited to one printing company per location?
- (b) Could the Postal Service requirements set forth in its printer statement of work (USPS-LR-11) be accommodated by a group of printers within a geographic area? Why or why not?

**USPS/MASAPB-T1-21 Response:**

- (a) No. The USPS states that the "commercial print sites will be geographically situated according to demand..." (USPS-T1, page 2). If demand warranted, more than one printing company could be at a given location.
- (b) The use of a group of printers within a geographic area is possible, however, the USPS has stated that it "presume[s] that a single printer will receive all volume for a given area" (OCA/USPS-T1-5).

USPS/MASAPB-T1-22. On page 16 of your testimony you include a quotation from *A Dictionary of Economics*, which states in part, "if the winner of the original bid thereafter enjoys a sunk cost advantage, parity bidding at contract renewal intervals cannot be presumed."

- (a) What is your understanding of how this applies to Mailing Online?
- (b) What "sunk cost advantage" would inhere to original bid winners? Please explain fully.
- (c) What is your understanding of the pace of change in the printing industry today?
- (d) How long does printing equipment last?
- (e) What is the expected lifespan of the print-on-demand equipment necessary for Mailing Online?
- (f) If equipment necessary for a successful bidder to perform printing and related services for Mailing Online is available on a lease basis, with no up front capital cost reduction fee, would that bidder have a "sunk cost advantage" during subsequent bidding cycles? Please explain fully.

**USPS/MASAPB-T1-22 Response:**

- (a) When contracts are rebid, the USPS' current subcontractor may have an advantage over other potential bidders equal to its sunk cost.
- (b) The sunk cost advantage includes the acquisition of equipment and facilities plus the operational expertise that are already in place for the original bidder.
- (c) If the term in the question "the pace of change in the printing industry" refers to technological innovation for printing, then the changes will depend on numerous factors including the type of printing, the willingness of the industry to change, and the incentives provided by customers, governments and companies that supply goods to the printing industry.
- (d)-(e) The useful life of printing equipment depends on numerous factors including the type of equipment, the level of utilization, maintenance and technological change.
- (f) The bidder may have a sunk cost advantage depending on the operational experience of the incumbent bidder and the ability of other bidders to obtain the same lease terms as the successful bidder.

USPS/MASAPB-T1-23. On page 16, line 11 of your testimony, you use the term "true competition". Please define this term and provide an appropriate reference supporting your definition.

- (a) Does "true competition" apply at the national, state and other levels to the same extent? Please explain your response.
- (b) What role, if any, does the necessity for printing contractors to meet performance deadlines that require entry of Mailing Online pieces to specific, geographically dispersed postal facilities play in your analysis of "true competition".
- (c) Do you believe that a printer bidding to become a Mailing Online contractor could have its physical plant located in New Mexico yet meet the performance deadlines in Florida?
  - i. If so, how could the printer expect to be competitive given the need to account for substantial transportation costs that printers in Florida would not need to incur?
  - ii. If not, how do you reconcile this with the statement, also on page 16 of your testimony, that "the second lowest bid in one geographic area would not receive any USPS business for Mailing Online because a higher bid, in a different geographic area, was selected by the USPS"?
- (d) What is your background and experience in government procurement regulations. Please explain in detail.

**USPS/MASAPB-T1-23 Response:**

The reasons that the USPS' proposed Mailing Online line service "prevents true competition for the subcontractors" are explained in my text, namely that the USPS' requirement that the winning bidder(s) be geographically dispersed presents a barrier to competition for other bidders. This condition results in a constraints on competition that otherwise would not occur in the market.

- (a)-(c) For purposes of the text referenced in this interrogatory, the competition discussed relates to the geographic areas which the USPS is utilizing to choose its anticipated 25 subcontractors. The geographic locations for the printing contractors is driven by the

USPS' design of Mailing Online. Therefore, the USPS has placed limitations on the ability of some companies to compete for Mailing Online contracts.

In a competitive environment, the potential bidder evaluates the revenues, costs and profits associated with entering the market. Each component of cost, including transportation, to supply the regional service would be evaluated. A potential bidder with a plant in New Mexico might have problems with performance deadlines in Florida but the ability to compete would be evaluated by the printer in New Mexico. The printer in New Mexico might be able to overcome problems with performance deadlines with added transportation costs, which might result in the New Mexico printer still providing service at a lower cost than other printers closer to the ultimate destination.

- (d) Since 1956, L.E. Peabody & Associates, Inc. submit bids for consulting services to state, local and federal governments. As part of assisting with the preparation of bids and administration of contracts, I am generally familiar with the regulations required for the contracts relevant to our company. For purposes of this proceeding I have reviewed the contract between the USPS and Vestcom International Inc. shown in USPS-LR-11 but my testimony does not attempt to address the competitive environment in which this contract was negotiated.

USPS/MASAPB-T1-24. On page 15 of your testimony you state, "a small number of printers will have or make the investment in capacity needed to meet the requirements for Mailing Online."

- (a) Do you mean that only successful Mailing Online bidders will have that incentive, or will unsuccessful or non-bidders have such an incentive. Please address the chapter that appears at Tr. 6/1489-1503 as part of your response.
- (b) In qualitative or quantitative terms, or both, what proportion of the entire capacity of the print-on-demand industry do you believe Mailing Online contractors will generate purely to provide Mailing Online services?
- (c) In qualitative or quantitative terms, or both, what proportion of the print-on-demand industry capacity do you believe Mailing Online contractors will generate to provide service other than for Mailing Online?

**USPS/MASAPB-T1-24 Response:**

- (a) Bidders that are not successful in obtaining a contract for the production of Mailing Online documents will not have any incentive to make investments in capacity related to Mailing Online. As noted in Attachment No. 1 to Presiding Officer's Information Request No. 2, Question No. 5, digital printing offers several advantages. (Tr. 6/1500-1502). These advantages are independent of the USPS providing the Mailing Online service.
- (b)-(c) For my analysis, the entire capacity of the print-on-demand industry is not required. However, my testimony does calculate the diversion of business from current printing businesses to Mailing Online to range between \$121 million for the first 2 years and \$521 million over the 5 year period is shown by the USPS.

USPS/MASAPB-T1-25. Please confirm that the equipment required to prepare documents in accordance with the Mailing Online specifications is widely available.

**USPS/MASAPB-T1-25 Response:**

Confirmed.

USPS/MASAPB-T1-26. Do you contend that Mailing Online will lead to the development of proprietary printing technology that will constitute an entry barrier for would-be Mailing Online printers? Please explain fully any affirmative response.

**USPS/MASAPB-T1-26 Response:**

The impact on printing technology due to Mailing Online is not known to me, but it is certainly conceivable that technology changes could produce entry barriers .



USPS/MASAPB-T1.27. Please refer to your testimony at page 15, lines 7 to 9, where you state that "the USPS may be able to offer lower prices than its competitors who are subject to sales and income taxes."

- (a) Prior to filing your testimony, did you read the testimonies of witness Tayman, USPS-T-9, in Docket No. R97-1, or the Commission's Opinion in Docket No. R97-1, at pages 21 to 23, concerning the Postal Service's need to recover prior years' losses?
- (b) Confirm that a private firm subject to federal income taxation can carry forward its net operating losses for the past 15 years and apply them against profits earned in subsequent years. If not confirmed, please explain.
- (c) Confirm that a firm subject to federal income taxation can carry back operating losses and offset them against profits earned in previous years. If so, what are the general rules governing the extent to which a private firm subject to federal income taxation may do so? If not confirmed, please explain.
- (d) Assume for this subpart that the Postal Service were subject to federal income taxation since its inception.
  - i. Do you believe the Postal Service would have incurred tax liability for any of the years of its existence since 1971? If so, please state the fiscal year(s) in which you believe the Postal Service would have incurred tax liability, what income you believe would be subject to taxation, and the total tax liability. For each year in which you believe that the Postal Service would have incurred tax liability, please also state whether such liability would have been subject to any refunds due to carry back losses. Please show all calculations, and provide sources for your figures.
  - ii. Assume that the Postal Service does not retire its entire Prior Years' Loss by the end of the experimental period. Do you believe that the Postal Service would pay federal income taxes during the experimental period? If so, please explain why the Postal Service would have any taxable net income.

**USPS/MASAPB-T1-27 Response:**

- (a) No.
- (b)-(d) I have not analyzed the impact of carry forward, carry back or recovery of prior years' losses based on the USPS being subject to income tax because that calculation is not required for my testimony. The calculation of the hypothetical taxes that the USPS would have paid (and any potential impact on postal rates) would require an in-

depth study of the USPS' accounting data. Any attempt to calculate the income taxes that the USPS would have paid requires data not available such as the proportion of the USPS' net income attributable to each state or locality and the consideration that the USPS' decisions for investment acquisition might change if the USPS' was a taxable entity.

**DECLARATION**

I, Roger C. Prescott, declare under penalty of perjury that the foregoing answers are true and correct, to the best of my knowledge, information, and belief.

Roger C. Prescott

Date: March 2, 1999

**CERTIFICATE OF SERVICE**

I hereby certify that I have on this date served this document upon all participants of record in this proceeding in accordance with section 12 of the rules of practice.

DATE: March 2, 1999

  
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Jan D. Volner