

SEPARATE OPINION IN CONCURRENCE WITH THE POSTAL RATE
COMMISSIONERS' RECOMMENDATION TO APPROVE THE MAILING ONLINE
EXPERIMENT IN DOCKET NO. MC 2000-2 AND DISSENTING FROM THE
MAJORITY'S RATE RECOMMENDATION

STATEMENT OF COMMISSIONER GOLDWAY

I regret that I must dissent from the rate recommendation and proposed fee schedule of the Commission majority. I fully support their decision to recommend that the Postal Service proceed with the Mailing Online Experiment and I am gratified that, as a result of the Commission's diligent review process, the Postal Service has stipulated to make the basic automation postage rate available to all those services that are functionally equivalent to MOL. However, I believe the PRC's fundamental statutory responsibilities include a rate review and recommendation process which identifies the lowest possible postal rates consistent with the ongoing efficiency of the Postal Service and that ensure fair and universal service.

The majority decision recommends the imposition of the system-wide average markup which is more than 73% greater than that requested by the USPS *and* recommends that markup be multiplied on a per impression cost basis that is five times greater than the Postal Service proposes.¹ I believe any decision to recommend markups, cost attributions and rates that are higher than those requested by the Postal Service must be made with great caution. Such a decision must be based on the clearest findings of Postal Service necessity, e.g., such rates are needed to cover costs or meet the revenue breakeven requirement – or clear findings that the rates as

¹ The majority opinion (hereinafter, "Opinion") adds that the difference between its attributable cost and markup analysis and the Postal Service proposal result in a typical 2-page First-Class piece costing 40.9 cents versus 37.9 cents (including 27 cents for postage). Opinion at i. The resulting 7.9% increase is not a small price difference, and the difference is magnified for larger pieces. For example, an 8-page spot color mailing would increase by 11.7 cents or 18.1%.

proposed would harm Postal Service competitors to such an extent that competition and ultimately consumers would be harmed. The Commission decision does not meet this test.

The majority decision does not dispute that the USPS requested markup would cover costs.² However its several decisions with regard to specific cost attributions plus its imposition of a high markup send the wrong signal to the Postal Service concerning any attempts it may make to innovate. It also sends the wrong signal to the private sector, which, if this opinion holds, will motivate them to appear before us in attempts to elevate Postal Service prices on competitive services as a way to dampen competition generally. As the Supreme Court has stated,³

cutting prices in order to increase business is the very essence of competition. Thus, mistaken inferences in cases such as this are especially costly, because they chill the very conduct the antitrust laws are designed to protect.

The majority claims to espouse application of general antitrust principles and correctly recites that antitrust is designed to foster fair competition, not to protect individual competitors.⁴ I find that it has misapplied or misunderstood those principles, protecting a small group of competitors at the expense of the overall public, e.g., recommending a higher-than-requested markup.⁵ Rather, in recognition of the value this service could provide to the general public, the Commission would be well served

² See *generally* Opinion at 59 *et seq.*

³ *Matsushita Elec. Indus Co. v. Zenith Radio Corp.*, 475 U.S. 574, 594 (1986).

⁴ See *generally* Opinion at 33.

⁵ See, e.g., these statements: “Many of the services provided by contract to Mailing Online reflect low costs relative to the competition due to the high volume that this service is predicted to generate. As noted above, the volume estimates available in this case are somewhat speculative, and a high markup will protect competitors from unfair, below-cost competition.” Opinion at 72. “The potential competition is not grounds for denying the Mailing Online experiment request, but it does increase the need to make certain that unfair advantages are not provided to the Service by a low cost coverage. One way to blunt accusations of bias in terms of the contribution to institutional costs is to use the system wide average coverage from the most recent rate case, R97-1, of 155 percent.” Opinion at 65.

by following its own decision in the earlier Mailing Online Service, Docket No. MC98-1 and, at a minimum, adopting a lower markup.

The Statutory Issue

An important reason for my decision to issue a dissent with regard to rates lies in the D.C. Circuit's statement about §3622(b)(5), one of the ratemaking criteria we must follow:⁶

As to §3622(b)(5), the Commission has consistently, and reasonably, held that it authorizes a reduction in rates to maintain the position of the Postal Service as a competitor in the mail delivery industry.

MOL is but one attempt by the Postal Service to innovate in order to survive into the next century, financially able to meet its universal service obligation. In order to fend off the ultimate challenges from electronic diversion, it must create new business opportunities. We may be skeptical of its capacity to succeed in new areas but, in fact, the Postal Service is obliged to do this by the postal laws. The postal policy of the United States, at 39 U.S.C. §101, however Byzantine it may seem at times, has one steadfast beacon, set forth at 39 U.S.C. §101(e):

In determining all policies for postal services, the Postal Service shall give the highest consideration to the requirement for the most expeditious collection, transportation, and delivery of important letter mail.

The Postal Service is attempting to meet this policy on two levels here. First, on the micro level, it has designed a service targeted to a small business market, one that is growing rapidly in today's economy. Second, if this venture is successful, the Postal Service will enjoy two economic benefits, one from the MOL service and one from an

⁶ United Parcel Service, Inc. v. U.S. Postal Service, 184 F.3d 827, 845 (D.C. Cir. 1999).

increased usage of the mailstream. Eventually, if the service proves a success, the Postal Service will reap financial rewards that can be passed on to the general rate-paying public.

In reaching the relatively high rate levels that accrue from its cost attribution and markup process, the majority must take into account 39 U.S.C. §3622(b)(4), which states that we must consider “the effect of rate increases upon the general public, business mail users, and enterprises in the private sector of the economy engaged in the delivery of mail matter other than letters.”⁷ We have wide discretion in applying the §3622(b) ratemaking factors,⁸ but there are problems with applying §3622(b)(4) in the context of experimental cases, and this case in particular.

First, the statute speaks to “the effect of rate increases upon the general public.” Here, though, we have not a rate increase but a brand new rate. Another problem with the statutory wording, which speaks only in terms of rate increases, is that consideration is to be given to some (but not all, as discussed below) Postal Service competitors. But Postal Service competitors, generally speaking, *like* rate increases (so competition against them is lessened). Perhaps one can argue that for the statute to make any sense, it should not apply in experimental cases or even permanent rate and classification cases when the Postal Service is proposing a wholly new service. After all, the competitive effects evidence, based as it on such necessary gossamer as projected volumes, is not often going to prove reliable.

The more serious statutory interpretation problem for the majority is that they seek to make *de facto* use of §3622(b)(4) to protect firms (such as MASA members) involved in the letter mail business. Perhaps the closest the majority comes to admitting

⁷ As we shall see, however, the majority avoids this statutory provision and concentrates on arguments concerning other rate setting criteria. The majority cannot escape the fact that its decision reflects the price competition arguments made by MASA, which directly implicate §3622(b)(4).

⁸ *United Parcel Service, Inc. v. U.S. Postal Service*, 184 F.3d at 845.

reliance on §3622(b)(4) is its statement that “the Commission statutorily is required to also consider both the benefits of competition and the *impact Postal Service products may have on enterprises in the private economy.*”⁹ The MOL proposal involves letter rates.¹⁰ The clear wording of §3622(b)(4), “other than letters,” is that the Postal Service letter monopoly should be protected. Note that the majority opinion studiously avoids direct mention of this criterion because its clear directive conflicts with the majority’s findings that “unfair competition” must be prevented.¹¹

Even if the above statutory infirmities could be overcome, I do not think the proper interpretation of §3622(b)(4) is to protect competitors at all costs. The Commission decision in the market test portion of the case states that a national policy favoring competition is reflected in the Postal Reorganization Act.¹² Here, that principle is weakened: “Whereas antitrust laws are meant only to protect competition and not the individual competitors, the Commission statutorily is required to also consider both the benefits of competition *and the impact Postal Service products may have on enterprises in the private economy.*”¹³ The majority attempts to reconcile these allegedly contradictory phrases in its discussion at pages 25-26 of the Opinion, which need not be repeated here. The problem with the majority’s ultimate position is that if one protects competitors without regard to the probable effects on competition and the consumer, one likely will end up with higher prices and the protection of inefficient operations. We are all sympathetic to struggling businesses, but the American economy and its citizens have prospered precisely because we recognize that in a market economy there are winners and losers.

⁹ Opinion at 25-26 (emphasis added).

¹⁰ Opinion at 2-3.

¹¹ See, e.g., Opinion at 65, 72.

¹² Mailing Online Service, Docket No. MC98-1, at 21.

¹³ Opinion at 25-26 (emphasis added).

Rather than avoiding mention of §3622(b)(4), I submit that one can and should interpret §3622(b)(4) to be consistent with the antitrust laws. After all, §3622(b)(4) tells us *to look at the effect on the general public and business mail users as well as competitors*, which should mean, among other things, that we act to ensure that the general public and business mail users generally will benefit from low (but above cost) Postal Service prices. As I discuss later below, our concern should focus on harm to competitors *if* it results in harm to competition and ultimately harm to consumers.

Even if one concedes that MASA has standing to seek the Commission's price protection, other factors in the statute, which we are obligated to consider, point to a lower markup.¹⁴

By its terms, §3622(b)(4) allows the Commission to consider lowering rates in order to protect 'the general public [and] business mail users . . . As to §3622(b)(5), the Commission has consistently, and reasonably, held that it authorizes a reduction in rates *to maintain the position of the Postal Service as a competitor in the mail delivery industry.* [emphasis added]

The National Policy Favoring Competition

The majority opinion states that the "Commission does not enforce the anti-trust laws—though anti-trust policies, principles, and concepts are often used as a framework for analyzing the competitive nature of a proposed service in setting rates and classifications."¹⁵ I think that §3622(b)(4) should therefore be interpreted so that competitors should be protected to the extent not doing so will harm the competitive process and ultimately consumers. I believe the Commission has misapplied basic competitive principles of our nation's economic policy, which is to protect competition,

¹⁴ United Parcel Service, Inc. v. U.S. Postal Service, 184 F.3d at 845, and cases cited therein.

¹⁵ Opinion at 25-26.

not competitors, in order to give consumers lower prices and a better selection of products. Generations of Supreme Court majorities, composed of liberals and conservatives alike, have espoused the same basic philosophy about the positive results of competition. So, for example, Justice Black said in a 1958 decision:¹⁶

The Sherman Act was designed to be a comprehensive charter of economic liberty aimed at preserving free and unfettered competition as the rule of trade. It rests on the premise that the unrestrained interaction of competitive forces will yield the best allocation of our economic resources, the lowest prices, the highest quality and the greatest material progress, while at the same time providing an environment conducive to the preservation of our democratic political and social institutions. But even were that premise open to question, the policy unequivocally laid down by the Act is competition.

When interpreting (b)(4) and considering raising a proposed rate, we need to pay particular heed to the Supreme Court's admonition that:

[W]e have rejected elsewhere the notion that above cost prices that are below general market levels or the costs of a firm's competitors inflict injury to competition cognizable under the antitrust laws.¹⁷

* * *

To hold that the antitrust laws protect competitors from the loss of profits due to such price competition would, in effect, render illegal any decision by a firm to cut prices in order to increase market share. The antitrust laws require no such perverse result.¹⁸

I wish that the majority had relied more on the reasoning used in the precursor to this proceeding, the unanimous decision in Docket No. MC98-1, where, in analyzing

¹⁶ Northern Pac. Railway v. U.S., 356 U.S. 1, 4 (1958).

¹⁷ Brooke Group Ltd. v. Brown & Williamson Tobacco Corp., 509 U.S. 209, 223 (1993).

¹⁸ Ibid.

intervenors' rate discrimination argument, the Commission stated that abstract assertions of rate discrimination were not dispositive, citing with approval *Brooke Group*, 509 U.S. at 220.¹⁹ The opinion there correctly observed that under accepted competitive analysis: "That below cost pricing may impose painful losses on its target is of no moment to the antitrust laws if competition is not injured: It is axiomatic that the antitrust laws were passed for the 'protection of competition, not competitors.'"²⁰ Note that during the market test proposal being examined in Docket No. MC98-1, the Commission approved a 125% cost coverage, even lower than that requested by the Postal Service here.

Using the Systemwide Cost Coverage Average as A Default

The majority decision adopts the same basic position it did in *Provisional Packaging Service*, Docket No. MC97-5, employing an arbitrary systemwide markup in response to assertions by an incumbent group of firms that its members cannot compete with the Postal Service. It reasons, in part:²¹

However, this experiment involves a nationwide service that may last more than three years. As MASA/PII points out this longer time period could negatively impact both existing businesses and future competitors. MASA/PII also points out that the competing businesses that may be harmed by Mailing Online extend beyond any providers of functionally equivalent services, to print shops serving small markets. For these reasons, MASA/PII recommends that the Commission consider a markup in the range of 50%, which equates to a coverage in the range of 150.

¹⁹ Docket No. MC98-1, Opinion at 23.

²⁰ *Id.* at 23, n.13, citing *Brooke Group*.

²¹ Opinion at 64-65. *Compare* Docket No. MC97-5, Opinion at 49: "An average cost coverage will provide a more level competitive playing field for the Postal Service and firms in private industry providing packaging services."

The potential competition is not grounds for denying the Mailing Online experiment request, but it does increase the need to make certain that unfair advantages are not provided to the Service by a low cost coverage. One way to blunt accusations of bias in terms of the contribution to institutional costs is to use the system wide average coverage from the most recent rate case, R97-1, of 155 percent.

There is no sound economic theory or legal principle for using the average as a starting point or a default. The Act presumes that one can consider the situation, including all of the factors, and reach a decision on the most appropriate markup. To default to the average when it will raise the rate level above not only cost but what is requested seems to me especially problematic.

Curiously, the majority also reasoned:²²

Many of the services provided by contract to Mailing Online reflect low costs relative to the competition due to the high volume that this service is predicted to generate. As noted above, the volume estimates available in this case are somewhat speculative, and a high markup will protect competitors from unfair, below-cost competition.

It is difficult to follow the logic in this rationale. As to the first sentence, it appears the majority is reasoning that low costs that arise because of high volume usage²³ (i.e., scale economies) are somehow problematic. If this statement means that the savings generated from efficiencies should not to be passed on to the consumer, then I strongly disagree. As to the statement that “a high markup will protect competitors from unfair, below-cost competition,” I have several comments. First, there is no evidence that MOL is below its costs. Second, if the statement means that the Postal Service proposal is below competitors’ costs, and this calls for a high markup, then we have precisely the

²² Opinion at 72.

²³ Such low costs may also reflect internal efficiencies of the printers the Postal Service has contracted or will contract with.

sort of naked protectionism that is antithetical to the antitrust laws. Such reasoning represents a no-win situation for the Postal Service, for when it operates inefficiently it is routinely castigated, but when it discovers an efficient way to operate, its competitors are protected. This, to me, seems an unacceptable theory of regulation. Finally, the majority's reasoning employs §3622(b)(4) *sub silentio*; use of this provision has grave legal problems, as discussed herein.

MASA's Arguments on Competitive Effects

It can be agreed that there is no evidence that the Postal Service has taken away MASA member business simply because, except for a brief, anemic, and now defunct market test, this is a brand new business. Instead, the majority must rely on the assertions of MASA members that in the future their businesses will be materially harmed because they will not be able to compete on price, in part because the Postal Service enjoys tremendous institutional advantages, and puts forth its own economic analysis of the USPS's supposed institutional advantages. I analyze each set of institutional arguments separately.

Before proceeding to a discussion of MASA's arguments, it should be pointed out that MASA's brief also takes the position that the Postal Service's MOL operation is not likely going to succeed, contradicting its own fundamental assertions that its members face dire competitive consequences.²⁴

And, as [MASA witness] Prescott noted, nothing in the Market Test (or, in anything the Postal Service has done since – note that the commencement of the service is to be postponed yet again) suggests that the Postal Service can realistically achieve these volumes.

²⁴ MASA Initial Brief, at 40.

Further, witness Schuh states that there are “hundreds of other mailing firms around the country” performing services similar to his.²⁵ The sheer number of firms suggests that the industry is highly competitive (highly unconcentrated, in antitrust parlance), that there is a substantial amount of local business, and that there are minimal or no barriers to entry. A typical industrial organization economic analysis would undoubtedly verify that such an industry is competitively healthy²⁶ and not going to succumb to a well financed entrant, whether it be the Postal Service or UPS.

Whether or not these firms will suffer some measure of diversion cannot be known for sure at this juncture – MASA is asking us to speculate that substantial diversion will occur. And, as explained throughout my opinion, diversion of business does not equate to unfair competition. But there also exists the possibility that the Postal Service will develop this market, and MASA members in turn can capitalize on the Postal Service’s efforts, e.g., getting a free ride on Postal Service advertising.²⁷ The services that MASA members perform hardly appear to be widely known to the public, and the Postal Service’s national presence may in fact help these types of services to become commonly known.

Schuh’s arguments that the Postal Service enjoys institutional advantages because of its size, legal status, and “deep pockets” has superficial appeal, but the advantages are not meaningful overall when scrutinized.²⁸ Schuh says his company cannot compete with the Postal Service’s advertising efforts. “Because of its sheer size, USPS is able to advertise on a scale that companies like mine cannot even

²⁵ Tr. 4/825.

²⁶ See, e.g., F.M. Scherer, *Industrial Market Structure and Economic Performance* (2d ed.), pp. 199-200, and 267 et seq.

²⁷ For a discussion of how “armies of imitators” capitalize on one firm’s innovations, see generally T. Levitt, “Exploit the Product Life Cycle,” *Harvard Business Review*, Nov.-Dec. 1965, pp. 81-94. The same article discusses how even high quality products must be promoted through discounting upon introduction, an important point to remember when determining the appropriate price level for MOL.

²⁸ Tr. 4/826 et seq.

contemplate."²⁹ However, the Postal Service's direct advertising costs for MOL are attributed to the cost base of the product. The Postal Service cannot subsidize its direct advertising from other classes of mail. To the extent the Postal Service enjoys some scope economies in advertising because of its "brand name," are we to deny consumers what is usually considered a productive efficiency? UPS, Staples and Pitney Bowes, three potential MOL competitors, have comparable brand name power. In our mixed economy of large and small businesses, we do not ban large companies from operating in certain sectors because they operate under economies of scale and scope. Consumers enjoy the savings generated from such economies. I would add that there is nothing to prevent groups of MASA members from collaborating in such efforts as advertising, marketing, joint purchasing, etc., in order to achieve similar economies. Joint ventures of this type are conducted lawfully and commonly in our economy without raising antitrust concerns.

The general assertion that big firms can operate more efficiently than small firms and outcompete them is simplistic. "In nearly all production and distribution operations, the realization of scale economies appears to be subject to diminishing returns."³⁰ In fact, diseconomies may set in with large size so that there is a U-shaped long run cost curve, especially where large size brings with it a large management bureaucracy.³¹ Cost-scale relationships are difficult to assess,³² and no such detailed assessment has been made here.

Schuh also complains that USPS pricing assumptions are unrealistic because it has priced its service "as if data will be received in a consistent and highly accurate

²⁹ Tr. 4/826. Of course if one derives most of one's business from a local area, there is no need to advertise on a broad scale, and targeted demographic marketing is likely quite economic.

³⁰ Scherer, *supra*, at 84.

³¹ *Id.* at 84 *et seq.*

³² *Id.* at 93 *et seq.*

form and there will be little need for direct interaction with the customer.”³³ Schuh says the USPS’s proposed operation will not be able to address the many issues between printer and customer that arise. However, Schuh seems to be pointing out a comparative advantage that MASA members will have over the Postal Service – the ability to provide personalized service with attention to detail. MASA’s members should be proud of their own successful record of rapid technological innovation, flexibility, and efficiency. Schuh’s argument also undercuts the majority opinion’s assertion that MOL is a high-value service.³⁴

Schuh’s price competition argument also is undercut by his assertion that a significant part of his firm’s costs are associated with servicing clients.³⁵ One can assume that if customers value the quality of service provided they will continue doing business with his firm. If they desire a lower level of quality at a lower price, perhaps MOL will be a better alternative. Consumers should not have to pay for services they do not want. Comparing costs for services with different features and quality levels is highly problematic. We surely should not be basing prices for MOL on a comparison with service that may be of higher quality and therefore more costly.

Schuh also argues that the Postal Service enjoys an unfair advantage because it is exempt from many taxes.³⁶ However, the bulk of MOL’s costs are printing contract costs (which we are marking up to form the final rates). That printing, in turn, is done by private sector firms that must pay taxes. So, for the bulk of MOL’s cost base, the Postal Service has no tax advantage.

MASA does not mention the regulatory disadvantage under which MOL will operate. The Postal Service’s offering has been scrutinized by competitors, in minute

³³ Tr. 4/829.

³⁴ Opinion at 69.

³⁵ Tr. 4/829.

³⁶ Tr. 4/830.

detail. Cost details, operational considerations, marketing ideas – all have been laid bare for the public to see. The Postal Service’s competitors can profit highly from this dissection in their own efforts.³⁷ Second, the Postal Service’s MOL proposal is essentially frozen. If it should decide that it needs a fundamental change in operations or prices, it must come back to the Commission for another public regulatory review. It cannot respond to operational innovations or price cuts from competitors except after going through another protracted administrative process. Indeed, standard marketing texts are awash with strategies on how firms can respond to competitive pressures – many of which are closed to the Postal Service, which operates in regulatory handcuffs.

Therefore I disagree with the Commission’s assessment that the Postal Service has tremendous institutional advantages that must be dealt with by imposing higher prices.³⁸ The majority opinion seems to view the Postal Service’s large size as a guarantor of success, but it is common knowledge that large, prominent firms fail all the time and hitherto small and unknown firms rise to prominence. Remember, Microsoft once was small. It is a matter of public record that the Postal Service has not been successful with some of its product innovations. It also is a matter of record that the Postal Service has not been successful in competing with private firms at times (e.g., the parcel business). Further, the majority’s focus on the Postal Service’s financial girth ignores an important principle of competition analysis -- notions that there is something inherently bad about large firms engaging in vigorous competition have been rejected by the Supreme Court: “It is in the interest of competition to permit dominant firms to engage in vigorous competition, including price competition.”³⁹

³⁷ See Levitt, *supra*.

³⁸ “The Postal Service has great economic power and vast resources at its disposal in comparison to most, if not all, potential Mailing Online competitors.” Opinion at 33.

³⁹ *Atlantic Richfield Co. v. USA Petroleum Co.*, 495 U.S. 328, 341 (1990), and other cases cited therein.

The majority also states that the Postal Service “does not have a requirement to ever produce a profit”⁴⁰ which when coupled with the “institutional contributions derived from the monopoly products” . . . “allows the Postal Service to take financial risks that would be otherwise unacceptable in the private sector.”⁴¹ I agree that the Postal Service is not disciplined by market forces in the same way as private firms are (e.g., from stockholders). I have already spoken of the substantial regulatory constraints that make product innovation troublesome for the Postal Service. But the statement that the Postal Service can take risks private sector firms cannot is unsubstantiated and probably false. If it were true, the Postal Service would not have withdrawn from new business ventures which turned out unpromising (e.g., retail sales of coffee mugs, etc.). In fact, this product innovation, like others that have come under our rate and classification scrutiny, have been modest extensions of the Postal Service product line. One can hardly call MOL a risky innovation when hundreds of firms (MASA members) are offering similar services. Private sector firms, in contrast, can and do enter entirely new markets far removed from their traditional lines of business.

⁴⁰ The issue of how non-profit institutions operate as compared to their for-profit counterparts is both complex and highly controversial, see, e.g., Wm. Lynk, “Nonprofit Hospital Mergers and the Exercise of Market Power,” *Journal of Law & Economics*, Vol. 38 (1995), 437-61. One cannot merely assert that non-profit institutions behave more recklessly in an economic sense. In my employment with non-profit organizations (museums and educational institutions) I did not experience such institutions engaging in irrational economic behavior merely because they were non-profit. For one thing, many non-profit institutions may internalize what would otherwise be classified as accounting-type profits, e.g., in the form of granting generous employee compensation (either in the form of high salaries or good benefits such as reduced work schedules). This internalization process may partially explain the purported wage premium enjoyed by Postal Service employees. (“There is broad agreement in the literature that the Postal Service pays a substantial wage premium over the private sector . . .” Wachter and Perloff, “A Comparative Analysis of Wage Premiums and Industrial Relations in the British Post Office and the United States Postal Service,” in Crew and Kleindorfer (ed.), *Competition and Innovation in Postal Services*, p. 119. Furthermore, non-profits are subject to political oversight, which serves to temper behavior, e.g., a museum by its board and contributors, and the Postal Service by Congress.

⁴¹ Opinion at 33.

The majority opines that the printer contracts with their minimum volume requirements and guaranteed payments are an example of the type of financial risk that would be unacceptable in the private sector.⁴² It then states:⁴³

The other effect of the minimum payment is to allow the Postal Service to secure a favorable printing price based on a guaranteed high volume of printing. The result is printer prices below what the competition can offer. * * * Therefore, the Commission cannot dismiss the potential for harm caused by indirect competition with the Postal Service.

This reasoning is internally contradictory. On the one hand, the majority is saying that the printer contracts are an example of risky behavior on the part of the Postal Service, but on the other hand that the contracts may prove *too* advantageous for the Postal Service. The majority cannot have it both ways. In fact, so-called minimum requirements contracts are common in the private sector, employed to assure vendors that their investment in equipment or realignment of their services is prudent.⁴⁴ From my vantage, such contracts seem eminently reasonable as a way to attract contractor services. The majority's castigation of a commonly-employed type of contract seems especially unwise when one considers that courts have a dim view of the Commission intruding upon Postal Service management decisions,⁴⁵ which is exactly what the majority opinion accomplishes.

I find it ironic that in its well-meaning attempt to protect one set of small businesses, the majority will accomplish this by requiring other small businesses (or "SOHOs") who wish to use MOL to pay higher fees. The majority opinion may result in

⁴² "For example, Mailing Online printer contracts contain minimum payment provisions irregardless of volume." Opinion at 34.

⁴³ Opinion at 34.

⁴⁴ Long distance telephone calling plans with monthly fees and inexpensive time-based rates are but one example of a minimum requirements contract which consumers use directly.

⁴⁵ See, e.g., *Newsweek, Inc. v. U.S. Postal Service*, 663 F.2d 1186, 1203 (2d Cir. 1981).

another irony here. By setting the fees higher than requested, if MOL fails, the Postal Service will be able to avoid responsibility for its own management of the new service and instead cast blame on the Commission.

Correct Market Analysis Needs to Be Performed When Analyzing Competitor Complaints

Witness Schuh's review of MOL's proposed pricing structure leads him to conclude that it will be impossible for his company to compete with it.⁴⁶ He states that his company's selling costs, excluding postage, run from 50% above Mailing Online on larger quantities to 250% above Mailing Online on small quantities.⁴⁷

However the antitrust issue that we should concern ourselves with is that of predatory pricing, i.e., *below-cost* pricing "for the purpose of eliminating competitors in the short run and reducing competition in the long run."⁴⁸ In *Brooke Group v. Brown & Williamson Tobacco Corp.*, the Supreme Court set forth the twin elements that must be proved in a predatory pricing case:⁴⁹ a plaintiff seeking to establish competitive injury resulting from a rival's low prices must prove that the prices complained of are below an appropriate measure of its rival's costs, and that the alleged predator has a dangerous probability of recouping its investment in below-cost prices. The Court noted:⁵⁰

Recoupment is the ultimate object of an unlawful predatory pricing scheme; it is the means by which a predator profits from predation.⁵¹ Without it, predatory pricing produces lower

⁴⁶ Tr. 4/829-30.

⁴⁷ Tr. 4/829.

⁴⁸ *Cargill, Inc. v. Monfort of Colo., Inc.* 479 U.S. 104, 117 (1986).

⁴⁹ 509 U.S. 209, at 222 and 224.

⁵⁰ *Id.* at 224.

⁵¹ The Postal Service is an especially poor candidate for even attempting predation because its rate requests during the so-called recoupment period would be reviewed by this Commission.

aggregate prices in the market, and consumer welfare is enhanced. Although unsuccessful predatory pricing may encourage some inefficient substitution toward the product being sold at less than its cost, unsuccessful predation is in general a boon to consumers.

And, as the Federal Trade Commission, one of two federal agencies that enforces our nation's antitrust laws, has noted:⁵²

A common complaint is that some companies try to monopolize a market through "predatory" or below-cost pricing. This can drive out smaller firms that cannot compete at those prices. But the lower prices a large retailer offers may simply reflect efficiencies from spreading overhead costs over a larger volume of sales. Because the antitrust laws encourage competition that leads to low prices, courts and antitrust authorities challenge predatory activities only when they will lead to higher prices.

I am concerned that uncritical acceptance of competitor complaints about Postal Service pricing will chill competition and innovation. There is no market analysis in the Opinion about possible entry barriers (although the Commission's decision acknowledges that there has been entry). Nor does the opinion analyze whether the public has possible substitutes to turn to if the Postal Service was able to drive out existing competitors (even though 39 U.S.C. §3622(b)(5) requires the Commission to consider the available alternative means of sending and receiving letters and other mail matters at reasonable cost).

Further, we need to look at such issues as the downward pressure on prices that competition from the Postal Service would bring to the market and the improvements in product/or service which other entrants such as UPS, Pitney Bowes, etc., might make to compete with MOL.

⁵² Federal Trade Commission, "Promoting Competition, Protecting Consumers: A Plain English Guide to Antitrust Laws," available on the internet at <http://www.ftc.gov/bc/compguide/index.htm>.

It is imperative that we evaluate possible consumer responses to price increases (such as substituting similar products) should MOL prevail as the dominant product. As to potential MOL substitutes, I think we should adopt the type of product market analysis used by antitrust authorities, such as the product market definition used in the Department of Justice and Federal Trade Commission Horizontal Merger Guidelines (1992). A price increase after the elimination of competition could be made unprofitable for the alleged predator (the Postal Service) by consumers switching to other products.⁵³ Indeed, in asking whether, for example, SOHO's could readily substitute other products⁵⁴ such as developing their own mailings on home computers using commonly available desktop publishing, running newspaper ads, using non-print media such as local cable, using targeted mailing available from marketing firms, etc., I am struck by the lack of participation in this case by parties that might offer SOHO's other ways to disseminate information.

The Commission has substantial experience and expertise in evaluating the various ratemaking factors under 39 U.S.C. 3622 in permanent cases, but relatively little with experimental cases. Practically speaking, it is a common practice in retailing to offer introductory prices so that one attracts new customers. It also is common knowledge that in retailing one can expect losses for a fairly long period until the

⁵³In considering the likely reaction of buyers to a price increase, the antitrust agencies take into account such evidence as: (1) evidence that buyers have shifted or have considered shifting purchases between products in response to relative changes in price or other competitive variables; (2) evidence that sellers base business decisions on the prospect of buyer substitution between products in response to relative changes in price or other competitive variables; (3) the influence of downstream competition faced by buyers in their output markets; and (4) the timing and costs of switching products. In attempting to determine objectively the effect of a "small but significant and nontransitory" increase in price, the antitrust agencies generally will use a price increase of five percent lasting for the foreseeable future.

⁵⁴ A product market definition should include products that are reasonably interchangeable in use. See the discussion of Product Market Definition in ABA Section of Antitrust Law, *Antitrust Law Developments* (4th ed. 1997), at 499 *et seq.* On the supply side, courts look to the ability of producers to switch production capabilities. *Id.* at 516-19. Defining a product market too narrowly erroneously magnifies perceived competitive risks. See, e.g., *United States v. E.I. du Pont de Nemours & Co.*, 351 U.S. 377, 394 (1956). It is likely that the majority's product market definition is too narrow.

business or product becomes established. One only has to look at how the stock market values some start-up firms that operate at losses in their formative period. The Postal Service is asking the Commission for nothing more than normal, ordinary operational flexibility.

The Commission in part bases its increase of the markup and the fee schedule above that recommended in Docket No. MC98-1 on the three-year length of the experiment and the permanent harm that might result to MASA members. I am not concerned about using the USPS's proposed 30% markup during the full length of the experiment. In discussing promotional pricing, the Areeda-Hovenkamp antitrust treatise notes the FTC's decision in *General Foods*, 103 FTC 204 (1984) "where the FTC concluded that three years of below-cost pricing by a firm with a 24 percent market share qualified as promotional."⁵⁵ In *Brooke Group*, the alleged below cost pricing went on for 18 months. There is simply no credible legal reason or market evidence to justify the belief that competitors will suffer lasting or permanent harm during the life of this experiment.

Even if I shared the misgivings expressed by the majority about the susceptibility of the future market to Postal Service competition, I am reassured by the fact that after this experimental phase, the Postal Service must return to the Commission for a permanent rate that might require a higher markup. At that point, we would have a realistic opportunity to examine the effects of the Postal Service's proposed pricing scheme on the market and consider raising rates if the lower rates created more harm than good.

⁵⁵ Areeda and Hovenkamp, *Antitrust Law*, Vol. 3, at 447, n.2.

The “Value of Service” Criterion and Volume Issues

I disagree with the majority’s application of the “value of service” criterion.⁵⁶ The relevant subsection of §3622(b) tells us to consider:

(2) the value of the mail service to both the sender and the recipient, including but not limited to the collection, mode of transportation, and priority of delivery.

First, it is important to remember that MOL is a printing and collating service (via computer), after which the MOL customer will be charged an appropriate postage fee. The decision correctly separates out the fact that MOL is designed as a convenient method to enter mail into the mailstream. The mailstream portion of the service is covered by the postage fee, which will be marked up in conformance with statutory criteria applied in the last omnibus rate case, and the markups for MOL’s postage fees are themselves relatively high.⁵⁷

The majority states MOL provides a high value of mail service to the sender and recipient of the mail, and concludes this justifies a high markup.⁵⁸ The opinion then describes the attributes of MOL that allegedly manifest this high value, e.g., allowing the sender to use a personal computer, entry of mail close to final destination, etc. The Commission did not discuss this “high value” in its market test opinion, which set the cost coverage at 125 percent. Much of the evidence, moreover, contradicts this conclusion of “high value.”

Regarding value to the sender, MASA itself portrays the MOL service as incapable of providing personalized service,⁵⁹ a point with which the majority opinion

⁵⁶ Opinion at 69-70.

⁵⁷ Opinion at 17: “Automation basic rates incorporate a substantial markup . . .”

⁵⁸ Id. at 69-70.

⁵⁹ Tr. 4/829.

agrees, noting that MOL “offers only a limited number of options to the customers.”⁶⁰ “The Commission views customer service as an important distinction between Mailing Online and the alleged competition. “Customer service is an important part of the product being offered by witnesses Schuh’s and Jurgena’s businesses that Mailing Online does not offer. This may account for a portion of the higher prices being charged by their businesses.”⁶¹ MOL’s electronic component makes it high in quality in terms of collection and mode of delivery,⁶² but I view the overall value of service MOL would provide as a cut-rate printing and collating service, perhaps not even up to the level commonly provided by MASA members.

As to the value to the recipient, not discussed by the majority, it should be comparable to the lower value of advertising mail, and therefore should call for a low markup.

The majority also concludes that the “uncertainty of volume and cost estimates makes it appropriate to attach a high markup to Mailing Online, thereby reducing the likelihood that this service will fail to meet the requirement that it recover attributable costs.”⁶³ Note, though, that in its market test opinion, when establishing a 125 percent markup, the Commission concluded:⁶⁴

⁶⁰ Opinion at 31.

⁶¹ Opinion at 32.

⁶² Opinion at 70. However, I disagree with the majority’s assertion that “the collection and mode of transportation for Mailing Online will be superior to that of any other postal product . . .” Ibid. MOL users will be generating a limited type of mass-produced mail pieces. MOL can not be used for many types of documents and cannot be used for parcels. So, e.g., if I wish to send out an important legal document expeditiously, the mode and collection of delivery of Express Mail is a type of high value service I might opt for. Or, I may wish a Priority Mail parcel to be picked up. One simply cannot compare MOL mass-production pieces with many other types of mail.

⁶³ Opinion at 71. The majority also worries that the volume projections “were developed a number of years ago . . .” Id. at 70. However, the competitive analysis done by MASA was submitted in February of 1999. The Commission itself has performed no market analysis of the industry at any time, which weakens its argument that the volume projections supplied are dated.

⁶⁴ Docket No. MC98-1, Market Test Opinion at 31.

As Mailing Online is configured, a high proportion of its costs are incurred on a unit basis. As a result, the risks that expected volumes will not be realized, and that start up costs will not be recovered and have to be borne by other classes of mail is minimized.

I would also point out that the Commission there found:⁶⁵

The Postal Service argues that because Mailing Online is a price sensitive experimental service in its start up phase, a markup somewhat below the average for mature classes is appropriate. The Postal Service argues that it will help this nascent service find its market and build volumes to the level that will support reasonable judgments about the nature of the market and the future viability of the service. [citation omitted] *The Commission concludes that these are reasonable grounds for recommending the 25 percent markup requested.* [emphasis added]

The Commission's opinion here not only contradicts its market test assertions about MOL, but also contradicts orthodox economic thinking. If demand for MOL is elastic (and the finding that MOL "is a price sensitive experimental service" seems to state that), then raising its price may lower the total dollar revenue produced. It is not surprising, then, that in discussing the value of service criterion, the majority opinion fails to take into account an important aspect of value of service, the degree to which service usage declines in responses to price increases. Although we have no historical record to assess own-price elasticity directly, MOL appears to be highly price sensitive, calling for a very low markup. The record is clear that there are a large number of printers who offer similar (and perhaps superior) printing and collating services, any one of whom can deposit mail at the variety of discount postage rates available.⁶⁶ But the competition for MOL is broader than this. The largest potential application by users probably will be short-run direct mail advertising and solicitation from individuals, small

⁶⁵ Id. at 32-33.

⁶⁶ MASA is a trade association of about 500 members, and PII is a trade association of about 2000 small printers and copy shop members. Opinion at 28.

businesses, home offices, and charitable organizations.⁶⁷ There appear to be a plethora of alternatives for MOL's potential users to convey their messages if MOL is perceived as not cost effective. These include other forms of media (including media that can employ narrow demographic distribution), more traditional kinds of Standard A mail preparation services, self-preparation of documents, web site advertising, etc.⁶⁸ Therefore, contrary to the majority opinion's § 3622(b)(2) analysis, I find that this criterion strongly supports a low markup.

The majority opinion also is at odds with its treatment of cost coverage for delivery confirmation in Docket No. R97-1. In approving an overall cost coverage of 107 percent,⁶⁹ the Commission recognized this as low because, inter alia, "the quality of the service is untested."⁷⁰ Here the service also is substantially untested, though the majority complains that the evolving nature of the service lends to the uncertainty of volume projections.⁷¹ Further, in R97-1 the Commission stated as to Priority Mail manual delivery confirmation that a low markup was justified because it "should further increase Priority Mail volumes" which were recognized as making a "large contribution."⁷² Here, MOL should attract more mail to classes which already have high markups.

⁶⁷ Opinion at 2.

⁶⁸ Compare the cost coverage analysis accorded Standard A Regular Mail in Docket No. R97-1, Opinion at 434-35. In adopting a 135 percent cost coverage, the decision seems to accept the Postal Service analysis that even though the mail is capable of demographic targeting, it has major competitors, including special interest magazines, local cable, and internet web sites.

⁶⁹ R97-1 Opinion at 585.

⁷⁰ Ibid.

⁷¹ Opinion at 72.

⁷² R97-1 Opinion at 585.

The Cost Attribution Issue

While the Postal Service's proposal to add 0.1¢ to each piece (or impression) to cover attributable costs understates some costs, in particular, credit card fees which have been identified in the evidentiary record presented in this case, the Commission majority has, in my opinion greatly overestimated other costs.

In choosing to recognize more than \$30 million in product-specific Information Technology expenditures as attributable, the majority included \$9.6 million that has already been spent in anticipation of the experiment phase and would, if the experiment were not permitted to continue, be accounted for by the Postal Service as general institutional research and development costs. Further, the \$20.7 million the Service anticipates investing in Information Technology for MOL during the experiment can either be considered (1) as an investment in the information network infra-structure of a 21st century Postal Service and, therefore, as institutional costs or (2) as expenditures that should be incorporated into rates for recovery if and when MOL becomes permanent. Moreover, when the sum of the estimated total attributable costs amounted to 0.42¢ per impression, the majority rounded up to 0.5¢, resulting in a 400% increase over the Postal Service's proposal. I would suggest eliminating the \$30 million and rounding down. Simply put, the PRC recommended 52% markup on these attributable costs would amount to a final rate of 0.75¢ per impression as opposed to the 0.13¢ per impression requested – a 477% increase.

The Commission also fails to consider two important factors contributing to MOL revenues. First, the great bulk of the costs being attributed, and then marked up, are printing costs which are the result of contracts between the Postal Service and private sector firms. These are passthroughs that cost the Postal Service nothing. If one views MOL essentially as the Postal Service being an agent for a consortium of printers, who in turn use the USPS internet portal, then it is questionable why the markup should apply to those printing costs at all. The problem is that when nearly all of the costs are contract costs, even a moderate markup has the potential to put rates above what

economists call “stand-alone costs.” Rates above stand-alone costs involve cross subsidy. All of the literature views stand-alone costs as an upper limit. There is no reason to view traditional markups as applicable in a situation like this. Second, the postal rate recommended for MOL, (the basic automation rate to which all parties in the case have stipulated), already includes a substantial markup.

The Public Will Benefit From A Lower Priced Service

I fear that the Commission’s imposition of a higher markup and higher attributable costs than that proposed may persuade the Postal Service not to offer this service (and may deter it from returning to the Commission with other proposals). That would be very unfortunate, for MOL could benefit the public in a variety of ways. The many benefits cited by the Commission when it approved the earlier MOL market test⁷³ bear repeating here:

There is also a reasonable expectation that Mailing Online will substantially benefit individual, home office, and small-volume business mailers by simplifying their interface with the Postal Service’s complex rates and regulations [consistent with § 3622(b)(7)], reducing their transaction costs [consistent with § 3622(b)(2)], and making it feasible for them to take advantage of automation and drop ship discounts that previously have been used predominantly by large volume mailers [consistent with § 3623(c)(1), (3), and (5)]. It also appears that it has the potential to speed delivery of the mail [furthering § 3623(c)(3)], and to attract significant new volumes of high quality, low-cost mail to the Postal Service. This is likely to make the Postal Service a more viable participant in the rapidly evolving communications market.

Mailing Online therefore has the potential to fulfill several of the most basic mandates that the Act imposes on the Postal Service. It holds out the promise of helping preserve the Postal Service as

⁷³Docket No. MC98-1, Market Test Opinion at 34-35.

a “basic and fundamental” public service, that can “bind the Nation together through the personal, educational, literary, and business correspondence of the people” and of extending “prompt, reliable, and efficient services to patrons in all . . . communities” through the internet, in furtherance of § 101(a). Making electronic access available to small businesses and other small organizations, and perhaps even to individuals, is likely to help the Postal Service provide “the most expeditious collection, transportation, and delivery” [§ 101(e)], and to help it give the “highest consideration to the prompt and economical delivery of all mail.” [§ 101(f)]

If Mailing Online proves to be a viable service, it has the potential to help “maintain an efficient system of collecting, sorting, and delivering mail nationwide” as required by § 403(b)(1). It therefore appears that the basic features of Mailing Online could significantly aid the Postal Service in its pursuit of the fundamental goals of § 403(a), which requires the Postal Service “to plan, develop, promote, and provide adequate and efficient postal services at fair and reasonable rates and fees.” Accordingly, the Commission finds that, on balance, it is in both the public’s interest and the Postal Service’s interest to allow Mailing Online to be offered briefly in a limited market as a step in determining whether it is likely to realize this potential.

Conclusion

I urge the Board of Governors to adopt the Commission’s majority decision on Docket No. MC2000-2 under protest, allow the recommended decision of the Commission to take effect and return the recommended decision to the Commission for a prompt reconsideration and a further recommended decision with regard to rates.