

USPS-T-2

BEFORE THE  
POSTAL RATE COMMISSION  
WASHINGTON, DC 20268-0001

REPOSITIONABLE NOTES MARKET TEST

Docket No. MC2004-5

DIRECT TESTIMONY  
OF  
KIRK KANEER  
ON BEHALF OF  
UNITED STATES POSTAL SERVICE



# CONTENTS

	Page
CONTENTS .....	i
AUTOBIOGRAPHICAL SKETCH.....	ii
I. PURPOSE OF TESTIMONY .....	1
II. PROPOSED RPN PRICING AND CLASSIFICATION FOR MARKET TESTING.....	1
A. Overview .....	1
B. Proposed Prices.....	3
C. Revenue and Cost Impact.....	4
D. Classification Criteria .....	5
E. Pricing Criteria .....	7

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## AUTOBIOGRAPHICAL SKETCH

3 My name is Kirk T. Kaneer and I am employed by the Postal Service as an  
4 economist in Pricing and Classification. I have held this position since 1998. My  
5 current duties are to develop pricing and classification proposals, cost analyses,  
6 forecasts, and implementation databases. Prior to this, I did similar work in  
7 Pricing from 1992 to 1998. Before working in Pricing, I was employed in the  
8 Labor Economics Research Division as an economist involved in labor  
9 negotiations. I have been employed by the Postal Service since 1988. I was a  
10 rate design witness for post office box service, special handling, and parcel air lift  
11 in Docket No. 2001-1 (USPS-T-38), and I was a cost and classification witness  
12 for post office box service in Docket No. R2000-1 (USPS-T-40). In Docket No.  
13 R97-1, I was the Periodicals Nonprofit and Classroom rate design witness  
14 (USPS-T-35) and rebuttal witness for post office box service (USPS-RT-19). I  
15 was the pricing witness for the Classroom subclass of Periodicals in Docket No.  
16 MC96-2 (USPS-CT-3) as well.

17 Prior to coming to the Postal Service, I worked from 1983 to 1988 at the  
18 Bureau of Labor Statistics (BLS), Office of Prices and Living Conditions,  
19 Consumer Expenditure Surveys Research Division. While employed at BLS, I  
20 published an article titled: *Distribution of Consumption by Aggregate Expenditure*  
21 *Share*, MONTHLY LABOR REVIEW, 109(2), 50-53, April 1986.

22 In 1982, I received a Master of Science degree in Economics from Florida  
23 State University in Tallahassee, Florida. In 1978, I received a Bachelor of  
24 Science Degree with double majors in Economics and Business Administration  
25 from the University of Central Florida in Orlando, Florida.

1 **I. PURPOSE OF TESTIMONY**

2 The purpose of my testimony is to present the Postal Service's pricing and  
3 classification proposals for a market test of "Repositionable Notes" (RPNs).<sup>1</sup> My  
4 testimony describes proposed classification and rate changes for First-Class Mail,  
5 Standard Mail, and Periodicals,<sup>2</sup> and it addresses the statutory criteria for their  
6 evaluation.

7 The Postal Service proposes to collect additional postage on those pieces on  
8 which mailers have affixed RPNs, reflecting the enhanced value of those pieces to  
9 senders and receivers.<sup>3</sup> The proposed classification changes would provide an  
10 appropriate and simple means to test the proposed RPN prices. Based on  
11 information from this market test, the Postal Service may subsequently propose a  
12 permanent pricing and classification structure.

13 My testimony describes the Postal Service's pricing of RPNs for its market test  
14 proposal and addresses the relevant statutory criteria for evaluating proposed  
15 classification changes and rates.

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<sup>1</sup> RPNs are defined in witness Holland's testimony: "A Repositionable Note ("RPN") is a Post-it™-type self-adhesive note that mailers can affix to the outside of a mailpiece. ... RPNs typically display advertising, product offerings, or marketing messages designed to encourage recipients to open, read, and respond to the internal contents of the mailpiece. USPS-T-1, page 1.

<sup>2</sup> These are found in Attachments A and B to the Request.

<sup>3</sup> "Overall, the Repositionable Notes product appears to be a valuable product for consumers and businesses." USPS-LR-1, Opinion Research Corporation, Repositionable Notes (RPN) Concept Research Report, page i.

1 **II. PROPOSED RPN PRICING AND CLASSIFICATION FOR MARKET TESTING**

2 **A. Overview**

3

4 As described by witness Holland, qualitative market research conducted on  
5 behalf of the Postal Service and actual mailer participation suggest that RPNs will be  
6 valued by many mailers. The addition of an RPN to a mailpiece has the potential to  
7 increase the likelihood that the recipient will open the mailpiece and respond to the  
8 advertising or solicitation that it contains. It also has utility to the recipient as a  
9 reminder that can be removed from the mailpiece and attached elsewhere.<sup>4</sup> RPNs  
10 thereby increase the value of the mailpiece to both the sender and recipient.

11 The value of an RPN attachment is over and above the value implied in the  
12 price of the mailpiece alone. This added value should be separately recognized and  
13 will further contribute to the overall cost recovery of the relevant class of mail. The  
14 RPN classifications and rates, discussed below, for First-Class Mail, Standard Mail,  
15 and Periodicals reflect the value of RPN and provide an effective way to garner

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<sup>4</sup> USPS-T-1, pages 1-5.

“The small and medium-sized business segments have mixed reaction to Repositionable Notes. These businesses recognize the additional costs of using Notes and some wonder whether the expected lift will be justified by the additional cost and production effort required.” USPS-LR-1, page ii.

“Large businesses show considerable interest in RPNs and there is a general consensus RPNs will enhance response rates to direct mail.” USPS-LR-1, page iii.

“Consumers view Notes both as attention-getting and as a useful means of sorting through the advertising mail they receive. Since Notes are at this point unique in the eyes of consumers, they service as ‘attractors’ to the mailpieces to which they are attached and at present have considerable potential to drive open-and-read rates. Consumers also seem quite taken with the interactive qualities of peeling-off and re-using Notes. Hence, the potential for increased message shelf life appears to be a realistic product benefit.” USPS-LR-1, page ii.

1 revenue reflective of that value. One of the purposes of the proposed RPN market  
2 test is to collect additional information about market acceptance of the initial prices  
3 and quantity demanded. If needed, the market test rates can be adjusted as part of  
4 any permanent classification filing for RPNs in light of the market test results.

## 5 **B. Proposed Prices**

6 I propose market testing the following RPN rates. For First-Class Mail, \$0.005  
7 (½ cent) in addition to applicable postage is proposed for each First-Class piece  
8 having an RPN affixed. I believe that this is a reasonable and modest amount for test  
9 purposes in light of the First-Class Mail, Presort Letters current average revenue per  
10 piece of 30.7 cents.<sup>5</sup>

11 For Standard Mail and Periodicals, I propose to test an RPN rate that is one  
12 cent higher than the proposed ½-cent First-Class RPN rate as a reasonable yet  
13 modestly higher amount for the purpose of this market test. Thus, Standard Mail and  
14 Periodical Mail RPN pieces would pay \$0.015 (1½ cents) per piece in addition to the  
15 applicable postage for the piece.

16 The rationale for the price differential is as follows. Recipients are more likely  
17 to respond to First-Class Mail advertising or solicitations than advertising or  
18 solicitations sent using other subclasses.<sup>6</sup> Therefore, it is reasonable to conclude  
19 that, while First-Class Mail value will be enhanced by using RPNs, the *relative*  
20 enhancement could be smaller for First-Class Mail than for Standard Mail or

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<sup>5</sup> Cost and Revenue Analysis report (CRA) FY 2003.

<sup>6</sup> Virtually all participants expect higher response rates and open-and-read rates from First Class Mail compared to Standard Mail. USPS-LR-1, page 19.

1 Periodicals pieces. In other words, RPNs could be expected to induce a greater  
2 increase in response rates for Standard Mail and Periodicals pieces compared to  
3 First-Class Mail pieces. It is reasonable, therefore, to propose a higher rate for RPNs  
4 on Standard Mail or Periodicals compared to RPNs on First-Class Mail.

5 In brief, these proposed RPN rates will maintain clearly identifiable  
6 relationships between the rates charged for RPN and non-RPN mail pieces,  
7 reasonably reflect the relative amounts of the RPN value added to mailpieces based  
8 on their class of mail, and avoid introducing undue rate schedule complexities, or  
9 additional costs. The proposed DMCS changes are shown in Appendix A to the  
10 Request and the proposed rate schedules are shown in Appendix B to the Request.

### 11 **C. Revenue and Cost Impact**

12 A quantitative assessment of the revenue generated by RPN attachments is  
13 difficult to ascertain with a high degree of certainty, since, to date, there has been no  
14 additional postage charged. There has been no distinct tracking of RPN volume as  
15 will be the case if this becomes a rate element.

16 As witness Holland explains, no impact on costs is expected.<sup>7</sup> Because the  
17 extremely low weight of RPN attachments is counted in determining the applicable  
18 postage, the basic postage is the same as if the RPN were on the inside of the piece.  
19 Piece-related costs, either in mail processing or delivery, are not expected to change  
20 by virtue of attaching RPNs. Consequently, as I explain, revenues generated by  
21 RPNs will help offset the institutional cost burden of the subclasses of the pieces.

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<sup>7</sup> USPS-T-1, pages 2 and 3.

1 A primary objective of the proposed RPN market test is to gauge the reaction of  
2 mailers to the proposed test classification and prices.<sup>8</sup> The decision of the sender  
3 whether to use RPNs is a complicated one, since there are many variables that affect  
4 the decision other than price, *e.g.*, the price charged by the mail service provider for  
5 producing the piece, the anticipated response rate, the value of the product or service  
6 being offered, etc. Therefore, the response to actual prices in the context of a live  
7 service during the market test is expected to provide a more accurate measure of the  
8 reaction of the marketplace to RPN service than further market research could  
9 provide.

#### 10 **D. CLASSIFICATION CRITERIA**

11 Section 3623(c) of title 39 U.S.C. requires the Commission to make its  
12 decision on establishing a new classification in accordance with the following factors:

##### 13 **1. the establishment and maintenance of a fair and equitable** 14 **classification system for all mail**

15  
16 The proposal for RPNs would enhance fairness and equity in the classification  
17 system. Senders deriving more value from the use of RPNs pay for that additional  
18 value. Senders not using RPNs do not pay more. This balanced approach results in  
19 a classification that is fair to both the user and non-user of RPNs, while fully  
20 considering the other applicable criteria.

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<sup>8</sup> USPS-T-1, page 5.

1           **2. the relative value to the people of the kinds of mail matter entered into**  
2           **the postal system and the desirability and justification for special**  
3           **classifications and services of mail**

4  
5           RPNs are of a distinct value and result in a wider variety of mail services.

6           Therefore, a separate classification is justifiable and desirable.

7           **3. the importance of providing classifications with extremely high**  
8           **degrees of reliability and speed of delivery**

9  
10           The RPN itself is not a classification associated with particular level of  
11           reliability, or speed of delivery. Nevertheless, senders are likely to attach RPNs for  
12           the purpose of increasing the mailpiece's visibility, thereby influencing reliability and  
13           speed of response.

14           **4. the importance of providing classifications which do not require an**  
15           **extremely high degree of reliability and speed of delivery**

16  
17           As noted above, the RPN itself is not a classification associated with particular  
18           level of reliability, or speed of delivery.

19           **5. the desirability of special classifications from the point of view of**  
20           **both the user and of the Postal Service**

21  
22           According to the market research, RPNs are expected to increase the  
23           response rates of advertising mail, and have value to consumers.<sup>9</sup> Thus the  
24           proposed new classifications are desirable to mailers who want new means to  
25           communicate with recipients.<sup>10</sup> RPNs are desirable classifications to the Postal  
26           Service because they provide a way to increase contribution from some core  
27           products without affecting the base rates, service quality, or costs.

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<sup>9</sup> LR-USPS-1, page 69

<sup>10</sup> LR-USPS-1, page 68

1           **6. such other factors as the Commission may deem appropriate**

2  
3           See pricing criterion 9, below.

4           **E. PRICING CRITERIA**

5           In assessing the proposed classification change, the Postal Service also  
6 addresses the applicable factors contained in 39 U.S.C. § 3622(b):

7           **1. the establishment and maintenance of a fair and equitable schedule**

8  
9           See classification discussion above.

10           **2. the value of mail service actually provided each class or type of mail**  
11 **service to both the sender and the recipient, including but not limited to**  
12 **the collection, mode of transportation, and priority of delivery**

13  
14           As witness Holland states, there are currently mailers who use RPNs on  
15 automation letters.<sup>11</sup> Although no postage is currently being charged, mailers incur  
16 additional expenses in having RPNs prepared and affixed to their mail pieces.  
17 Therefore, it is logical to conclude that mailers value RPNs. Moreover, the market  
18 research of the RPN concept supports the idea that RPNs have value to both  
19 senders and receivers. The focus group results show that mailers are receptive to  
20 paying additional postage on pieces that bear RPNs. Of 84 focus group participants,  
21 76 responded that they were willing to pay \$.005 to use RPNs on First-Class Mail,  
22 and 62 of the 84 participants indicated they were willing to pay \$.015 to use RPNs on  
23 Standard Mail.<sup>12</sup> Thus, RPNs will add value to the mail service provided by First-  
24 Class Mail, Standard Mail, and Periodicals at my proposed test rates.

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<sup>11</sup> USPS-T-1, page 2.

<sup>12</sup> LR-USPS-1, page 70.

1           The proposed prices of RPNs will not greatly alter the economics of RPN use.  
2           When asked to assume an increase in response rates, small and large business  
3           segments are generally willing to pay higher incremental postage for using RPNs  
4           than the levels tested in this research.<sup>13</sup> In fact, market research suggests that First-  
5           Class Mail and Standard Mail senders are willing to pay considerably more postage  
6           than the rates I propose.<sup>14</sup> Therefore, the rates I am proposing are modest, and while  
7           the Postal Service does not have the data necessary to project the market outcome  
8           with a high degree of accuracy, my proposed rates are reasonable rates to test the  
9           market value of RPN usage.

10           The RPN proposal enhances value in a more fundamental way. RPNs offer  
11           options to the sender to attract interest, and to improve the probability of a potential  
12           response. As such, the value to the sender is enhanced. Value to the recipient may  
13           be enhanced also. The information provided outside of the envelope on the RPN  
14           may help the recipient to decide whether to open the mail piece, and possibly place  
15           the RPN in a conspicuous location as a reminder.

16           **3. the requirement that each class of mail service bear the direct and**  
17           **indirect postal costs attributable to that class or type plus that portion of**  
18           **all other costs of the Postal Service reasonably assignable to such class**  
19           **or type**

20  
21           As witness Holland states, the Postal Service does not believe RPNs result in  
22           any increase in operational costs.<sup>15</sup> My proposed prices, while modest, should  
23           generate revenue that could more than offset any unexpected incremental direct or

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<sup>13</sup> LR-USPS-1, page iii.

<sup>14</sup> See LR-USPS-1, page 70.

<sup>15</sup> USPS-T-1, pages 2-3.

1 indirect costs that might arise from handling RPN mail. In the more likely event that  
2 the associated costs are nonexistent, the entirety of the revenue generated by my  
3 proposed rates will go toward the institutional cost burden of the subclasses of the  
4 host piece.

5 **4. the effect of rate increases upon the general public, business mail**  
6 **users, and enterprises in the private sector of the economy engaged in**  
7 **the delivery of mail matter other than letters**

8  
9 Establishing a price for RPNs has little effect on the general public or private  
10 delivery enterprises. My proposed rates will affect only mailers who choose to use  
11 RPN service during the market test., including the small number of firms who have  
12 already used RPNs. The modest RPN rates I have proposed are reasonable,  
13 because even firms already using RPNs may discover more effective ways of  
14 employing RPNs in their business ventures, especially in light of the expansion of  
15 availability of the program to more rate categories. In general, the ½-cent RPN rate  
16 for First-Class Mail and 1½-cent RPN rate for Standard Mail and Periodicals  
17 represent a small percentage of the total postage paid and an even smaller  
18 percentage of total production costs of the piece, such as printing, paper, and design  
19 costs.<sup>16</sup> Thus the current “early adopting” RPN mailers, who are adept at product  
20 innovation, are less likely to be deterred from seeking the potential gains of using  
21 RPNs, or to forgo the valuable marketplace experience, by the modest rates I have  
22 proposed for the one-year duration for this market test.

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<sup>16</sup> “ Regarding RPN production costs, participants seem readily willing to accept the portion of cost related to printing, materials, and affixing (presented to them as approximately \$0.04 per piece). Taken as a percentage of their mailpiece averages, this seems reasonable to them.” LR-USPS-1, page 37.

1           **5. the available alternate means of sending and receiving letters and**  
2           **other mail matter at reasonable costs**

3  
4           Establishing a price for RPNs does not affect the availability of alternative  
5 means for disseminating material that could otherwise be sent as First-Class Mail,  
6 Standard Mail, or Periodicals, with or without RPNs. Because the use of RPNs  
7 during the market test would have the effect of increasing the total price for services  
8 offered by the Postal Service, providers of alternative means of sending mail matter  
9 will not be unfairly disadvantaged by RPN service.

10           **6. the degree of preparation of mail for delivery into the postal system**  
11           **performed by the mailer and its effects upon reducing costs to the Postal**  
12           **Service**

13  
14           RPNs do not reduce Postal Service costs *per se*; however, in order to utilize  
15 them, customers will be required to meet preparation requirements designed to  
16 prevent any foreseeable cost impact.

17           **7. simplicity of structure for the entire schedule and simple, identifiable**  
18           **relationship between the rates or fees charged the various classes of**  
19           **mail for postal services**

20  
21           The RPN proposal introduces only two new rates: \$0.005 per piece for eligible  
22 First-Class Mail letters and flats, and \$0.015 per piece for eligible Standard Mail and  
23 Periodicals letters and flats. Adding these two rates should not unduly complicate the  
24 rate schedule. The likely users of RPNs are sophisticated mailers who are familiar  
25 with the Postal Service pricing schedule and are unlikely to be confused by the  
26 addition of these new rates. Moreover, any added complexity is outweighed by the  
27 value RPNs bring to mailers who will use them, and by the fact that only mailers who  
28 use RPN will have to be concerned about this portion of the rate schedule.

1           My proposed prices help to maintain a clearly identifiable relationship between  
2 the rates charged for RPN mail and non-RPN mail, between those pieces that benefit  
3 from the added value of RPNs and those that do not. My rates also reasonably take  
4 into account the relative differences in valued added between the subclasses eligible  
5 to use RPNs, as described above.

6           **8. the educational, cultural, scientific, and informational value to the**  
7           **recipient of mail matter**

8  
9           Not applicable.

10          **9. such other factors as the Commission deems appropriate**

11  
12          In traditional ratemaking, the Postal Service and the Commission have  
13 recognized the value of various mail classifications in the markup assigned to those  
14 classifications over their attributable costs. In this instance, because costs are not  
15 affected, the proposed prices cannot be based on costs that are marked up. Instead,  
16 the proposed prices reflect a recognition of the value derived from an additional  
17 feature that mailers may take advantage of. The need for this approach, which,  
18 although non-traditional, is consistent with the other criteria, can be viewed as one of  
19 the "other factors" to be considered in establishing a price for the classification.