

BEFORE THE
POSTAL RATE COMMISSION
WASHINGTON, D.C. 20268B0001

REPOSITIONABLE NOTES PROVISIONAL SERVICE

Docket No. MC2004-5

RESPONSES OF UNITED STATES POSTAL SERVICE WITNESS KANEER
TO INTERROGATORIES OF THE DIRECT MARKETING ASSOCIATION
(DMA/USPS-T2-1-7)

Pursuant to Order No. 1420, the United States Postal Service hereby provides the responses of witness Kaneer to the following interrogatories of the Direct Marketing Association: DMA/USPS-T2-1-7.

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

Respectfully submitted,

UNITED STATES POSTAL SERVICE

By its attorneys:

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DMA/USPS-T2-1 At page 1 of your testimony, you state, "The proposed classification changes would provide an appropriate and simple means to test the proposed RPN prices." What do you mean by "test the proposed RPN prices"? What information would this proposed test give you that would inform the Postal Service's consideration of "a permanent pricing and classification structure"? (See USPS-T-2 at page 1, lines 11-12).

RESPONSE:

The question quotes the summary section of my testimony. The answer is found in the body of the testimony at page 3: "information about market acceptance of the initial prices and quantity demanded." In the simplest terms, the test will answer the questions: "Are mailers willing to pay a modest postage amount for the service feature to help offset the institutional cost burden of the subclass, and, if so, how many pieces with RPNs will they send?"

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DMA/USPS-T2-2 At pages 2-3 of your testimony, you state, “The RPN classifications and rates . . . provide an effective way to garner revenue reflective of that value.” Is it a fair summarization of your testimony to conclude that, working with mailers, the Postal Service has found a way to make mail service “add value” (i.e., to become more effective as an advertising medium) and that the Postal Service wants to share financially in this added value? Please explain any “no” answer as completely as possible.

RESPONSE:

The testimony discusses how the six classification criteria and nine pricing criteria are met and specifically addresses the statutory requirement that postage rates reflect the value in a context of fairness and equity. See my testimony at pages 5-11. The RPN proposal embodies a tiny adjustment in the way the Postal Service's institutional cost burden is shared among mailers, with those who find mail with RPNs valuable sharing a greater portion of that burden than those who do not. There is nothing new or inequitable in this.

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DMA/USPS-T2-3 Please refer to Section B (“Proposed Rates”) at pages 3-4 of your testimony.

(a) Please provide calculations of the rate increases that would be charged for the addition of RPN’s, expressed in terms of percentage increases over the average rates per piece separately for each class and subclass of mail for which the RPN service is proposed to be available.

(b) Please provide a correlation in quantitative terms between the percentage rate increases provided in response to question 3(a) and the Postal Service’s estimate of the extent to which RPN’s add value to pieces of mail in the classes and subclasses in question.

(c) At lines 19-20, page 3 of your testimony, you state, “. . . the *relative* enhancement could be smaller for First-Class Mail than for Standard Mail . . .” (Emphasis in original). Do you have any basis for believing that the relative enhancement for Standard Mail is three times greater than for First-Class Mail? Do you have any basis for believing that an RPN-based rate surcharge for Standard Mail that is substantially greater than three times larger than an RPN-based surcharge for First-Class Mail, when calculated on the basis of an average rate increase, has any correlation to the relative value added by RPN’s to Standard Mail and to First-Class Mail? Please explain as completely as possible, with references to any available data quantifying relative value.

RESPONSE:

(a)-(b) There are no rate increases being proposed since prices for RPNs do not yet exist and all other rates are unchanged by this proposal. To the extent an automation letter bears an RPN today as part of the current phase of the incremental testing of this program, then that piece will no longer be eligible to include an RPN without paying the appropriate RPN price once it is established. Regarding the relative total postage for pieces with and without RPNs, one can simply perform the mathematical calculation of the percentage difference as follows: (price with RPN/price without RPN) – 1.

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Please note that these questions wrongly imply that there should be strict relationships between average subclass rates per piece and RPN rates. If there were, numerous RPN rates would result, making communication and test administration unduly complex for this esoteric product.

(c) A very important factor to consider is the fact that postage is only a portion of the cost of producing and affixing RPNs and therefore it is that *total* cost which directly influences mailers' and advertisers' decision-making in this regard. Those other costs undoubtedly vary and therefore I would have no way of knowing what percentage of those costs postage represents and could not do the type of analysis your question presupposes even if I felt it were appropriate. In the end, as with most other pricing decisions, the proposed prices will need to be evaluated within the context of the market in which they operate. Postal pricing has not so far yielded itself to such easy-to-use "rules of thumb" that eliminate judgment, and perhaps never should. There is no calculation such as "three times greater enhancement" that is, or should be, part of this pricing exercise.

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DMA/USPS-T2-4. It appears from your testimony that the specific rate increases reflected in the USPS proposal (i.e., 0.5 cents for First-Class, and 1.5 cents for other classes) were, in fact, chosen arbitrarily. Do you agree with this assessment? If not, please provide as complete an explanation as possible for the Postal Service's choice of these exact numbers, including any and all rate benchmarks that the Postal Service used in making these choices.

RESPONSE:

Not at all. First, as I indicated in my testimony, my decision was significantly influenced by the fact that this was one of the set of prices tested in the market research. See USPS-T-2, at page 7, which cites the market research report (USPS-LR-1) at page 70. Note the "total" line and last column: First Class "Willing to Pay \$.005 and Standard "Willing to pay \$0.015." In both classes, a good number of the participants indicated a willingness to pay these rates. Moreover, a key goal of the proposal is to test this finding by an actual offering of the product for a limited time to any and all customers in the marketplace. Should the results indicate that RPN postage levels need adjusting, that can be accomplished in a subsequent filing, if any. See also my response to question 3 above. In any event, the prices are not arbitrary; but as is the case with all of our pricing, reflect judgment after weighing all of the relevant information.

There are a wide variety of options that could conceivably be considered in developing the proposed prices. They run the gamut from no charge for the service to the higher level of charges suggested in the market research. In fact, the market research shows that participants' unaided estimates of RPN price ranged from 0 to 50 cents for First-Class Mail and Standard Mail, with subtotal averages ranging from 3 cents to 7 cents. (See USPS-LR-1, p. 70). However, providing the RPN feature for free does not reflect its value. Conversely, while the higher prices, suggested by the market

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research participants, might potentially maximize the short term contribution from the RPN features, they may not foster its long financial viability. In the end, the Postal Service sought prices that reasonably reflected RPN value, that were not onerous given the total postage costs, that allowed the concept to be fully tested and that were fully consistent with the statutory requirements. This proposed prices meet all of those tests.

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DMA/USPS-T2-5 At page 5, lines 1-2 of your testimony, you state, "A primary objective of the proposed RPN market test is to gauge the reaction of mailers to the proposed test classification and prices."

(a) Please describe in as much detail as possible the ways in which the test will enable the Postal Service to gauge the mailers' "reaction" to the proposed prices. Please include in your explanation as complete a description as possible of the information that the Postal Service would obtain that it would not have been able to obtain in any other way (e.g., through a market test with no increased price for RPN's).

(b) Please describe as completely as possible the ways in which this information concerning mailers' reaction will be used by the Postal Service in future classification and rate decisions.

RESPONSE:

(a)-(b) Simply put, the test will tell us how much volume we get at the prices we propose to test. It is axiomatic that the best way to gauge a response to a price is to charge it and see how much volume is produced. A market test without prices, as suggested in the question, would tell us nothing about mailers' reaction to actual prices. An actual test in the market is superior to further market research. While the market research we did had value in gauging whether a sufficient market exists for a potential product and what the general reaction might be at certain price levels, market research is not always sufficiently precise in determining the actual response. Potential customers' predictions of possible future behavior is simply not as accurate as actual customers' reactions to established prices for a product that exists in the marketplace.

The market research in this case indicated some mailers' willingness to pay even higher prices than those I have proposed. The goal of the Postal Service in this case was not to maximize the contribution of RPNs, but rather to develop prices that reflect the statutory criteria, as I demonstrate in my testimony.

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The volume and revenue data will be used to determine whether and how to continue or adjust this program. The data will be used in similar ways to other volume and revenue data.

Finally, please note that, since there currently are no prices for RPNs, it is inaccurate to state that I am proposing to increase them; rather I am proposing to establish them. See the response to DMA/USPS-4.

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DMA/USPS-T1-6. Please refer to Section D of your testimony.

(a) Would you agree that, under the Postal Reorganization Act of 1970 the relationship between various, specific rate levels is a central factor in determining the “fairness” and “equity” of a rate schedule? Please explain in detail any “no” answer.

(b) Would you agree that the Postal Service in this case has provided no quantitative analysis of the fairness of the relationship between the proposed RPN surcharge for First-Class Mail (i.e., 0.5 cents) and the proposed RPN surcharge for the other classes (i.e., 1.5 cents)? Please explain in detail any “no” answer.

(c) Would you agree that the Postal Service in this case has provided no quantitative analysis of the fairness of the relationship between the proposed RPN surcharges, on the one hand, and the rest of the entire postal rate schedule, on the other hand? Please explain in detail any “no” answer.

(d) Would you agree that the Postal Service’s testimony concerning the fairness of the RPN surcharges is limited to a single qualitative judgment that the RPN surcharge for First-Class should be smaller than the RPN surcharge for other classes? Please explain in detail any “no” answer.

(e) Assuming that USPS net revenues would increase under the proposal in this case and that the average net revenue per piece received by the Postal Service from some classes would increase as a result thereof, relative to the average net revenue per piece received by the Postal Service from other classes, do you believe that the contributions to institutional costs of the Postal Service after the rate increase made by each of the various classes and subclasses will meet the criteria of Section 3622(b) of the Postal Reorganization Act of 1970? If so, what is that belief, and what is the basis for such belief? Please explain fully.

RESPONSE:

(a) The proposed rates were analyzed in terms of the nine pricing criteria, as reflected in my testimony. I am hesitant to identify any single factor as “central”; because it might result in over simplifications, and/or overly broad conclusions.

(b)-(c) Please see my response to question 3 above. I do not accept the premise of the question that fairness can be measured quantitatively.

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(d) No. My testimony provides a detailed discussion of the basis of the two proposed test rates, which includes addressing the classification and pricing criteria, theoretical arguments, and market research results, as well as pointing to potential subsequent adjustment in light of the results of the test proposed herein.

(e) Yes, because the likely effects on the overall cost coverages of the affected subclasses are likely to be quite small. Moreover, it is common for the Postal Service to propose and for the Commission to recommend experimental and other classifications changes between rate cases, most of which have some small contribution impact. I am not aware of an instance when either the Postal Service or the Commission has believed this fact made it necessary to alter the existing permanent rates or require that such changes be proposed and made only as part of an omnibus rate proceeding. I do not see why this proposal should be an exception to that practice. To the degree that this or other proposals yield significant enough impacts to materially affect the contribution or cost coverages, further adjustments can be and are best considered in the context of a general rate increase and should not be a bar to product innovation between rate cases.

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DMA/USPS-T2-7 Please refer to page 8, lines 4-6 of your testimony, where you state, “. . . market research suggests that First-Class Mail and Standard Mail senders are willing to pay considerably more postage than the rates I propose. Therefore, the rates I am proposing are modest.” (See, also, your testimony at page 8, line 22, and page 9, lines 12 and 21).

(a) Please explain in as much detail as possible your meaning of the word “modest” and your reasons for believing that the rates you are proposing are “modest.”

(b) Do you mean that you believe that the proposed prices are less than the market will bear? Please explain your answer in as much detail as possible.

RESPONSE:

(a)-(b) I use the word “modest” as defined by Merriam-Webster at <http://www.merriam-webster.com/cgi-bin/dictionary?book=Dictionary&va=modest> as “**4 a** : limited in size, amount, or scope.”

The question truncates my sentence and thereby misses the conclusion. The full sentence reads: “Therefore, the rates I am proposing are modest, and while the Postal Service does not have the data necessary to project the market outcome with a high degree of accuracy, my proposed rates are reasonable rates to test the market value of RPN usage.” As discussed in response to DMA/USPS-T2-4 and 5, I do not think that the goal is to maximize contribution, but rather to develop prices for the market test that reflect the knowledge we gained from the market research, that are consistent with the Act, and that will provide useful information in evaluating the future of this product.

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.

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