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Docket No. MC98-1

DIRECT TESTIMONY

OF

SHERYDA C. COLLINS

ON BEHALF OF

THE OFFICE OF THE CONSUMER ADVOCATE

February 8, 1999

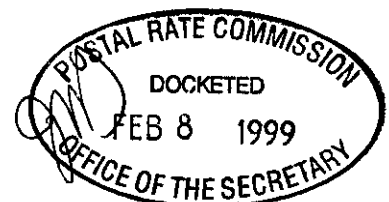


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DIRECT TESTIMONY

OF

SHERYDA C. COLLINS

STATEMENT OF QUALIFICATIONS

My name is Sheryda C. Collins. I have been employed by the Postal Rate Commission since January 1972. I was first assigned to the Office of the Special Assistant, and later to the Office of the Technical Staff, Officer of the Commission (Litigation Staff), and the Office of Technical Analysis and Planning. As a Rate Analyst and a Rate and Classification Analyst on the Commission's advisory staff, I prepared technical analyses and designed rates and classifications. My work product was incorporated within the Commission's Decisions in Docket Nos. R74-1, R87-1, R90-1 and R94-1, and in numerous classification dockets.

As a Rate and Classification Analyst on the Litigation Staff, I assisted in preparing testimony and exhibits on pricing and rate design in Docket Nos. R76-1 and R77-1. I performed technical analyses in connection with Docket Nos. MC76-5 and R78-1. I was a witness in Docket Nos. MC76-4 and MC79-2. In Docket No. R80-1, as a major rate design witness, I proposed rates for First-Class Mail, Priority Mail, Express Mail, fourth-class mail and special services. I also proposed a new rate category for First-Class Mail. In Docket No. MC95-1, I

1 testified about pricing and relative cost coverage levels. In the Special Services
2 Classification case, Docket No. MC96-3, I testified about and made proposals
3 regarding Certified Mail, Return Receipts, Insured Mail and Express Mail
4 Insurance, and Postal Cards. As an Office of the Consumer Advocate (OCA)
5 witness in Docket No. R97-1, my testimony supported a different level of rates
6 for Standard B Library Rate mail than those proposed by the Postal Service.

7 I am a graduate of the University of Massachusetts and have taken credits
8 toward an MBA degree at George Washington University. I have taken courses
9 in economics, public utility regulation, statistics, accounting, data processing, and
10 programming.

1 I. PURPOSE OF TESTIMONY

2 The purpose of this testimony is to provide the Office of the Consumer
3 Advocate's response to the Commission's Notice of Inquiry (NOI) No. 1, Item 6.
4 This testimony responds to the request of the Commission for assistance in
5 developing the record on the appropriate markup for Mailing Online in the
6 experimental phase of this docket. As stated in the NOI, "[t]he Commission
7 concluded that a 25 percent markup was not unreasonable for the limited market
8 test."¹ In issuing this NOI, the Commission alerts the parties that it will consider
9 a range of options with regard to the markup for this proposed experimental
10 service: the 25 percent markup as proposed, as well as higher or lower
11 percentages. Below, I will demonstrate that the 25 percent markup should be
12 the upper bound and that there are valid reasons, including precedent, to set the
13 markup at a lower level.

¹ Notice of Inquiry No. 1 at page 6. "The Commission concluded that a 25 percent markup is not unreasonable for the limited market test. The Commission, however, reached no conclusions concerning the appropriateness of a 25 percent markup for subsequent phases of Mailing Online." PRC Op. MC98-1 (Phase 1) at 33.

1 II. THE UPPER BOUND OF THE MARKUP SHOULD BE 25 PERCENT

2 The Mailing Online Service is proposed as a new special service.² As
3 such, the Postal Service argues that this new service's fee markup should be
4 compared to other special services and the markups on annual mailing fees.³ I
5 agree. The proposal is for a fee for a new service which is provided in addition
6 to postage for the appropriate subclass. The proposed fee markup is, therefore,
7 not directly analogous to the markups applied in determining rates of postage for
8 subclasses of mail. Also, First-Class Mail and Standard A mail currently provide
9 substantial contributions to institutional costs. The special service, Mailing
10 Online, will provide additional value to such mail. Thus, if Mailing Online causes
11 new volume to be added to the system, even with a smaller than average

² The Request, Attachment A: Market Test and Experimental Domestic Mail Classification Schedule Language, contains the proposed DMCS language.

³ Postal Service Brief at 10-11. "The proposed cost coverage is reasonable and appropriate in light of the characteristics of Mailing Online. Mailing Online permits customers to send letters and flats at First-Class Mail and Standard Mail automation rates. In this respect, Mailing Online is analogous to the annual mailing fees which enable customers to obtain discounted rates. Such fees benefit both customers and the Postal Service through reduction in the cost of mailing and increases in mailstream efficiency. These fees therefore typically have a low cost coverage; in Docket No. R97-1, the Commission recommended a 115 percent cost coverage for annual mailing fees. Mailing Online is expected to produce similar benefits, and thus merits a similarly modest cost coverage.

"Moreover, most of the major special services were recommended based on cost coverages of less than 125 percent. Relatively lower cost coverages make sense because special services not only provide a direct contribution to institutional costs, but also provide an additional, indirect contribution, by adding value to other postal products and thus increasing their usage." (Footnotes omitted.)

1 markup, Mailing Online would cause a non-trivial addition to the recovery of
2 institutional costs.

3 A review of the Commission's Decision in Docket No. R97-1 shows that
4 for most of the major special services the Commission recommended cost
5 coverages of 125 percent or below—often significantly below. Examples of this
6 include:

7	<u>SERVICE</u>	<u>COST COVERAGE</u>
8	Post Office Boxes	110%
9	Certified	113
10	Registry	123
11	C O D	112
12	Stamped Envelopes	105
13	Stamped Cards	125
14	Annual Permit Fees	115

15 These cost coverages are well below the systemwide average coverage of 155
16 percent.⁴

17 In addition, a review of the previous two omnibus rate cases shows cost
18 coverages of most special services to be well below the systemwide average.
19 For example, in Docket No. R90-1, the systemwide average coverage was 150
20 percent. In contrast, in the same docket, Certified cost coverage was 124
21 percent; Insurance cost coverage was 117 percent; COD cost coverage was 104

⁴ See PRC Op. R97-1, App. G, Schedule 1.

1 percent; Money Orders cost coverage was 100 percent; and Stamped Envelopes
2 cost coverage was 105 percent.⁵ In Docket No. R94-1, the Postal Service
3 proposed fee increases for special services which generally followed the Postal
4 Service's proposed across-the-board 10.3 percent increase. With some
5 exceptions, the Commission recommended fees consistent with those proposed
6 by the Postal Service. Thus, a number of relative cost coverage levels were
7 preserved from the previous case.⁶

8 The Postal Service also argues that a lower rather than higher markup is
9 appropriate for Mailing Online because its targeted customers are price
10 sensitive.⁷ A relatively low markup will encourage customers to try the service
11 and measure its effects on their business operations. Witnesses Wilcox and
12 Campanelli both attest to the benefits of the new service, its ease of use and
13 benefit to their very small businesses.⁸ Witness Garvey testifies that Mailing

⁵ See PRC Op. R90-1, App. G, Schedule 1.

⁶ PRC Op. R94-1 at para. 5425. "The Postal Service's proposed increases for special service fees follow generally the 10.3 percent across-the-board approach to rate changes, as modified by rounding constraints and the requirement that fees cover attributable costs of each service." (Footnote omitted.)

⁷ USPS-T-5 (Plunkett) at 18. "The Postal Service's market research indicates that Mailing Online's target customers are price sensitive. . . ." See also Postal Service Brief at 11: "Target customers for Mailing Online service appear to be price sensitive." *Id* note 14: "First-Class Mail customers appear most sensitive to price."

⁸ USPS-T-7 (Wilcox) at 2-3. "Being able to automate this whole project was appealing to me and it has proved to be a real time saver. I can now get the entire mailing completed in about half an hour. And because of the ease of the process, the mailings get completed.

"The Mailing Online program has other benefits. For one, it caused me to purge my mailing list of bad addresses. . . . It felt good when I found out that this pilot program was being offered to small business owners like me. After all, government is supposed to help the people. We trust the Postal Service to get

1 Online is expected to be highly beneficial for both small business users and the
2 general public.⁹ It also will benefit the Postal Service as a whole by bringing new
3 volume to the system.¹⁰ I agree.

4 Somewhat analogous to the consideration of the level of markup to be
5 applied to the proposed Mailing Online special service is how the Commission
6 considered this matter in approving the new special service classification in
7 Docket No. R97-1, Delivery Confirmation. This service provides customers with
8 the date of delivery or attempted dates of delivery for Priority Mail, Parcel Post,
9 Bound Printed Matter, Special Rate and Library Rate Mail. It is available to
10 individuals, and small and large businesses. The Postal Service maintained that
11 its proposed low fees and markups reflected the reality of the marketplace,
12 where customers are quite price sensitive. The Commission agreed and set the
13 cost coverage for Delivery Confirmation at a "low" 107 percent. It said, this
14 "balance[s] a number of considerations such as recovery of costs, value of

our mail delivered, and small business are the ones who really need this kind of product. It will help us to grow and save money."

USPS-T-8 (Campanelli) at 3-4. "As with most businesses, time is money for me, and Mailing Online has been a phenomenal time saver. . . . Another important benefit has been that Mailing Online has made it easy to clean my address lists. . . . I must say that I have been fully satisfied with Mailing Online. . . . It is a very intuitive product and that contributes to its efficiency and effectiveness."

⁹ USPS-T-1 (Garvey) at 1. "This service uses advances in technology to benefit our customers, especially individuals and small- and home-based business, who would not otherwise have access to sophisticated digital printing technology and to bulk automation mail rates."

¹⁰ USPS-T-5 at 7 and 19: "By making it easier for customers to produce mail, Mailing Online is expected to result in a net increase in mail volume. . . . Mailing Online customers are unlikely to be current users of presorting services"

1 service and degree of mail preparation” and that this low coverage “is not
2 objectionable because the quality of the service is untested.”¹¹

3 A similar statement could be made regarding Mailing Online. A low
4 markup for the Mailing Online Service also is justified by the expectation that the
5 service will provide systemwide benefits. Another consideration is that the
6 postage associated with the mail pieces will also provide additional contribution,
7 especially with First-Class Mail.¹²

8 In the past, the Commission has been cautious when recommending the
9 introduction of new rates and services. When considering unknowable possible
10 cost changes, the Commission has, for example, properly limited the
11 passthrough of new discounts to less than 100 percent of the calculated cost
12 differences.¹³ However, in this case, a novel approach to pricing eliminates the

¹¹ PRC Op. R97-1 at para. 5975. “The Postal Service’s proposed fees for delivery confirmation are reasonable and the Commission recommends them. They balance a number of considerations such as recovery of costs, value of service and degree of mail preparation. Overall, the cost coverage for delivery confirmation is low at 107 percent, but this is not objectionable because the quality of the service is untested and its value of service is less than that of return receipt, which provides more information to the mailer. . . . Delivery confirmation’s low markup also is justified by the expectation that delivery confirmation may provide system-wide benefits such as measuring attainment of service standards.”

¹² USPS-T-5 at 19. “Moreover, the introduction of Mailing Online will produce additional First-Class Mail and Standard Mail volume. Therefore, in addition to providing contribution through its own markup, Mailing Online will indirectly improve postal finances to the extent that the service attracts new volume to these subclasses.”

¹³ See, e.g., PRC Op. R90-1 at paras. 5938-41. “The first issue we address is the Service’s decision to take what it describes as a ‘moderate step’ toward recognition by passing through approximately one quarter of the reported shape differential for nonprofit mail and approximately one half for regular rate mail. . . . Having considered the parties’ positions, we conclude that the Service’s proposal

1 possibility that this new service's contribution will decrease in the face of any
2 attributable cost increases.

3 The proposed pricing approach is to apply a specified markup to the
4 actual printer costs (as determined by written contracts) plus the Postal Service's
5 internal system development costs.¹⁴ This will provide unprecedented flexibility
6 and allow printer costs to vary by actual regional differences in labor and real
7 estate costs. And, it cannot be overemphasized, this markup approach
8 guarantees that Mailing Online unit revenues will exceed attributable costs and
9 thus contribute to institutional costs. In consideration of this fact, perhaps a
10 markup closer to the seven percent recommended by the Commission for the
11 Delivery Confirmation service in Docket No. R97-1 would be a more appropriate
12 markup for this new service.

represents a generally appropriate degree of recognition . . . for the introduction
of a new discount"

¹⁴ USPS-T-5 (Plunkett) at 2 and 18. "In lieu of a set fee schedule for the Mailing
Online experiment, the Postal Service proposes the establishment of a markup,
which would be applied to the actual printer costs—as determined by the written
contracts between the Postal Service and the contractors providing pre-mailing
services—plus the Postal Service's internal system development costs. . . . The
markup would be applied to the actual premailing costs of each customer's
transaction, resulting in premailing fees that would vary depending on the
options selected by the customer."

1 III. CONCLUSION

2 I believe that the proposed 25 percent markup should be considered the
3 absolute upper bound for the Mailing Online service. Because of the cost
4 coverage security provided with the novel markup pricing approach proposed in
5 this case, the Commission should carefully evaluate whether the markup should
6 be lower, and perhaps substantially lower, than the one proposed by the Postal
7 Service.