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

**COMPLAINT ON CHARGES FOR THE
BULK PARCEL RETURN SERVICE**

DOCKET NO. C99-4

**DIRECT TESTIMONY OF
LAWRENCE G. BUC
ON BEHALF OF THE
CONTINUITY SHIPPERS ASSOCIATION**

Dated: December 17, 1999

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AUTOBIOGRAPHICAL SKETCH

My name is Lawrence G. Buc. I am the President of Project Performance Corporation (PPC), a consulting firm headquartered in McLean, Virginia. PPC provides management, information technology, and environmental consulting services to private and public sector clients. At the firm, I direct a practice that focuses on cost and economic analysis, usually in a postal or environmental context.

I attended Brown University and graduated in 1968 with an AB with honors in mathematics and economics. In 1978, I received an MA degree in economics from the George Washington University of America. While there, I was a member of Omicron Delta Upsilon, the national honorary economics society.

I have been involved in Postal Service rate and classification cases for a large part of my professional career. I joined the Revenue and Cost Analysis Division of the United States Postal Service in March of 1975 and have analyzed postal costs ever since. I have worked not only for the Postal Service, but also for the United States Postal Rate Commission (PRC) and a variety of private clients. I have participated in seven previous rate cases: R74-1, R76-1, R77-1, R84-1, R90-1, and R97-1. In the course of these proceedings, I performed

analyses on a variety of elements of the cases, drafted direct and rebuttal testimony, prepared and drafted responses to interrogatories, and provided support to cost, pricing, revenue requirement, and volume witnesses. In R84-1, R90-1, and R97-1, I appeared as a witness for intervenors before the Postal Rate Commission. I also appeared as a witness for the Postal Service in MC76-1 and for the Office of the Consumer Advocate in MC77-2.

I. PURPOSE AND SCOPE OF TESTIMONY

The purpose and scope of my testimony is divided into two sections. The first section rolls forward the costs for the Bulk Parcel Return Service (BPRS) from FY 1998 (as provided by the Postal Service in its Cost Study as revised) to FY 2000. The second section provides an analysis of the cost coverage factors which supports the conclusion that the current cost coverage is too high.

II. ESTIMATING FY 2000 BPRS COSTS

This section of my testimony develops BPRS unit cost for FY 2000. I start with the FY 1998 unit costs for BPRS from the Postal Service's BPRS Cost Study and roll them forward to FY 2000.¹ Table 1 shows the five different cost components that comprise BPRS unit cost.²

¹ The BPRS Cost Study was released by the Postal Service on October 30, 1998. The report was recently revised to reflect the mail processing costing methodology adopted by the Postal Rate Commission in Docket No. R97-1.

² These costs are taken from the PRC version of Table 3 Summary of Unit Costs, BPRS Cost Study, p. 7.

Please note that these cost estimates are likely to be overstated since the estimates for the BPRS Cost Study were developed under the assumption that costs should not be underestimated: "Since BPRS is a relatively new service, assumptions are made to ensure that cost estimates are not underestimated" (BPRS Cost Study, p. 2). In several different places, the BPRS Cost Study justifies particular assumptions by saying not that they will produce the most accurate estimates with the available data but that they will avoid producing an underestimate. For example: "...[U]sing the Special Standard B CRA adjustment factor has the potential to overestimate the true volume variable unit cost of BPRS mail processing. Since this is consistent with the approach taken in this study to make assumptions that will avoid underestimating costs, the Special Standard B CRA adjustment factor is used" (BPRS Cost Study, p. 4). As a result, the estimates in Table 1 err on the side of overestimating the attributable unit costs of BPRS.

Table 1. FY 1998 BPRS Unit Costs

Cost Components	Unit Costs (cents)
Collection	4.3
Mail Processing	59.4
Transportation	33.7
Delivery	2.4
Postage Due	4.0
Total	103.8

The rollforward of unit costs to FY 2000 focuses on projected changes in cost level from FY 1998. The Postal Service's Rollforward Cost Model also considers non-volume workload changes, additional days, and anticipated cost reductions and other programs.³ These additional factors are not considered in the rollforward performed here because I roll forward attributable unit costs and am unaware of any cost reductions or other programs in FY 1999 or FY 2000 that would affect BPRS costs.

Changes in personnel costs are used to project cost level changes for Collection, Mail Processing, Delivery, and Postage Due. The rollforward from FY 1998 to FY 1999 is based on actual changes in average hourly rates. I obtained these averages from the year-to-date portion of the National Payroll Hour Summary Reports for AP 13 for PFY 1998 and 1999. Because the PFY 1999 Reports do not appear to include all City Delivery Carrier costs (presumably because the NALC arbitration decision was not made until late in the fiscal year), I use the Clerk and Mailhandler cost level factor to project the

³ Description of the Production of Cost change Factors to Support the Postal Service Roll-Forward Model, R97-1 LR-H-12.

Collection and Delivery cost components in addition to the Mail Processing and Postage Due cost components. The figures are shown in Exhibit 2.

The personnel cost level projections from FY 1999 to FY 2000 are performed using the terms of current labor contracts. The contract provisions for general wage increases and Cost-of-Living Adjustments (COLAs) are the same for FY 1999 and FY 2000 for the contracts negotiated by the three relevant unions: the APWU contract covering Clerks, the NPMHU contract covering Mailhandlers, and the NALC contract covering City Delivery Carriers. I perform the rollforward by applying these increases successively to the average hourly rate in AP 13 for PFY 1999 and then calculating the weighted average hourly rate for all of PFY 2000. Given the above problem with the average hourly rate figures for City Delivery Carriers from the National Payroll Hour Summary Report, the figures for Clerks and Mailhandlers are used to provide an average hourly rate base for the Collection and Delivery cost components in addition to the Mail Processing and Postage Due cost components.

The union contracts specify two COLAs per year. The COLA formulas are based on the Consumer Price Index for Urban Wage Earners and Clerical Workers (CPI-W). I use DRI's projections of future changes in this index to derive COLA increases for PFY 2000. The projections of the CPI-W and the associated COLA wage increases are shown in Exhibit 1. The projections of PFY 2000 average hourly rates and the development of yearly cost level factors are shown in Exhibit 2.

I use changes in transportation cost indices to project cost level changes for Transportation. This is the rollforward procedure specified in the Postal Service's Rollforward Model for non-personnel costs. Exhibits 3 and 4 develop transportation cost level factors for FY 1999 and FY 2000 using the DRI cost indices for Trucking Operations and Private Transportation. The rollforward uses the cost level factors derived from the Trucking Operations index, since over 90 percent of Standard B's Purchased Transportation costs are for highway transportation. The cost level factors derived from the Private Transportation index are provided for comparison. It is worth noting that the rollforward would be less if I used the Private Transportation index instead.

Table 2 shows FY 2000 unit costs for BPRS, using the method described above and the personnel and non-personnel cost level factors developed in Exhibits 1-4. The calculations underlying this table are shown in more detail in Exhibit 5.

Table 2. FY 2000 BPRS Unit Costs

Cost Components	Unit Costs (cents)
Collection	4.6
Mail Processing	63.8
Transportation	35.9
Delivery	2.6
Postage Due	4.3
Total	111.2

III. COST COVERAGE/PRICING

I have reviewed Docket No. MC97-4 which created the Bulk Parcel Return Service (BPRS) in relation to the policies of Title 39 and the nine factors stated in Section 3622(b). When originally established, the coverage for BPRS was set at 156%. Under the 1998 BPRS cost study (as revised), the actual coverage is 168%. The application of the Title 39 policies and the nine factors show that the current cost coverage for the BPRS of 168% is too high. The cost coverage should be 135% which is the coverage applied to Standard A Regular mail. My analysis supporting these conclusions is set forth below.

The first factor of "fairness and equity" is the foundation on which all the other factors are based, and provides the basis for balancing the other factors. §3622(b)(1). The current BPRS coverage of 168% contradicts the first factor. The 168% coverage is overstated in relation to this type of mail (Standard A regular) and to other similar return services, i.e. Bound Printed Matter. In addition, the Postal Service's "approach" to the BPRS cost study was to "make assumptions that will avoid underestimating costs." BPRS Cost Study, pp. 4, 5. The Postal Service's assumption of costs at their upper bounds should lead to cost coverage at its lower bounds in order to maintain a fair and equitable schedule.

The "value of the service" in factor 2 looks at the inherent worth of the service provided to the sender and recipient. §3622(b)(2). The value of the BPRS service is much lower than the current cost coverage. Parcels returned under BPRS are Standard A Regular mail which has a coverage of 135%. As Standard A Regular mail, BPRS parcels receive low priority in terms of transportation and

processing; only ground transportation is used; and the parcels are returned to designated postal facilities for pickup by the mailer at a predetermined frequency specified by the Postal Service or delivered by the Postal Service in a bulk manner and frequency specified by the Postal Service.

Other similar return services, such as Bound Printed Matter, have much lower cost coverages. Bound Printed Matter has a coverage of 136%. In R97-1, the Commission noted that the coverage proposed by the Postal Service for Standard A Regular was similar to Bound Printed Matter which it described as "another subclass used for bulk national mailings of (among other things) advertising materials." R97-1, p. 434. In fact, Bound Printed Matter provides a greater value in that the Postal Service delivers Bound Printed Matter returns to the company; by comparison, half of the BPRS users pick up their BPRS returns.

The value of the BPRS service is even lower than the value of the outgoing parcel under Standard A Regular mail at 135%. The "value" of the service on the outgoing Standard A leg is at its highest because, at that time, the parcel represents the delivery of the merchandise to the customer closing a sale. By comparison, on its return BPRS leg, the "value" of the service is the by-product of an unsuccessful sales transaction.

The difference in the value of the service for the outgoing and return legs is further shown by the experience of Cosmetique, a member of the Continuity Shippers Association and a BPRS mailer. Cosmetique tracks its BPRS returns according to whether the customer will continue their membership and receive the next shipment, or whether

the customer cancels their membership (and there is no next shipment and thus no potential next sale). Cosmetique's data from mid-1997 through mid-1999 shows that in 73% of the returns, the customer cancels their membership; conversely, in only 27% of the returns does the customer continue their membership. In short, 75 percent of the time, the BPRS return marks the conclusion of a business relationship.

I have also reviewed data from Cosmetique for the years 1997, 1998 and 1999 (through November) showing the number of opened versus unopened BPRS returns Cosmetique received. The percentage of opened versus unopened BPRS returns for each year is shown below:

	<u>Opened</u>	<u>Unopened</u>
1997	56.0%	44.0%
1998	54.4%	45.6%
1999 (Nov)	53.6%	46.4%

The data shows that neither the establishment of BPRS, nor the recent minor modification to BPRS to include opened returns, affected the Postal Service's actual handling of opened returns. The Postal Service always returned the parcels even if they were opened. The modification only codified the Postal Service's pre-existing practice. Moreover, the value of the service to the mailer is the same whether the return has been opened or unopened. Cosmetique has informed me that it processes unopened and opened returns in the same manner. The value of the BPRS service has not increased as a result of the recent minor modification.

Although a company may be able to reuse product that has been returned, the company incurs additional costs beyond the BPRS fee in order to do so, such as processing the returns, and restocking the product. Opened returns require greater scrutiny than unopened

returns before the merchandise can be reused. There is also return product that cannot be reused and must be scrapped.

One competitor in the continuity product market has reported to me that each unit of a main line of its products (representing forty percent of its business in terms of both volume and revenue) costs 30.77% more when re-introduced to inventory after return by the Postal Service than when taken directly from inventory for the first time, owing to the costs associated with re-integrating the product into inventory after being returned (including the cost of damages goods). This data shows the substantial costs for reusing returned product.

The return of the product also significant helps the Postal Service. The Postal Service noted that the companies can "more readily" dispose of the product in an "environmentally sensitive way than is possible for the Postal Service, given the wide array of contents." Direct Testimony of Mohammad Adra, MC97-4, USPS-T2, 12.

The BPRS fee of \$1.50 would more than meet the requirement that BPRS mail "bear the direct and indirect postal costs attributable" to it as required by factor 3. §3622(b)(3). At that rate, a contribution of 135% to institutional cost would be recovered.

Factor 4, which considers the impact of rates on consumers and mailers, is also served by decreasing the BPRS rate to more closely reflect the actual cost of service as shown by the 1998 BPRS Cost Study (as revised). §3622(b)(4). BPRS was created to remedy a draconian increase in the Third Class Single Piece (the predecessor to Standard A and the rate previously applied to these parcel returns) in Docket No. R94-1. In R94-1, the Third Class Single Piece rate increased by an average of 66.25% in the 8-16 ounce range (which is

the range for BPRS users). The highest Third Class Single Piece rate paid was \$2.95 (for one pound, ground service of 7-11 day delivery) which was only \$0.05 less than Priority Mail (for up to two pounds, air transportation within 2-3 day delivery). The establishment of BPRS only provided interim relief to the general public and BPRS users. Further relief is now known to be warranted. Factor 5 considers the impact on alternatives services. §3622(b)(5). There is no economically realistic alternative to the Postal Service return of BPRS parcels. This factor favors lower BPRS rates.

Factor 6 looks at the reduction of costs through the mailer's preparation of the mail. §3622(b)(6). The bulk processing of BPRS parcels, the requirement for machinability of the parcels and the fact that half of the BPRS mailers pick up the BPRS returns establish that Postal Service costs are reduced through BPRS.

Factor 7 favors a straight forward fee structure. §3622(b)(7). There will be no effect on the per piece fee structure. This will continue to facilitate a straight forward and easily understood fee structure.

Educational, cultural, scientific and informational considerations of factor 8 do not apply. §3622(b)(8).

In conclusion, the policies of Title 39 and the nine factors of section 3622(b) support the lower cost coverage of 135%.

Exhibit 1. COLA Adjustments to Wage Costs

Trigger Month	Actual CPI-W (1967=100) [1]	Ending Date of Corresponding Quarter	CPI-W Projections (1982-84=100) [2]	Projected 6-month Increase in CPI-W (1982-84=100) [3]	Projected CPI-W (1967=100) [4]	CPI-W Point Increase [5]	Wage Increase [6]
January-99	479.7				479.7		
July-99	486.3	9/30/1999	1.638		486.3	6.6	\$0.1650
January-00		3/31/2000	1.656	1.1%	491.6	5.3	\$0.1325

[1] U.S. Bureau of Labor Statistics.

[2] DRI projections, CPIW series.

[3] Percentage increase in [2] from period 6 months earlier.

[4] Actual values from [1] for 1999. Projected value for 2000 using $(1 + [3]) \times$ CPI-W from 6 months earlier.

[5] Point increase in [4] from period 6 months earlier.

[6] Wage increase corresponding to [5] using COLA formula of 0.4 points = \$0.01 per hour, R97-1 LR-H-12.

Exhibit 2. Average Wage Cost-Level Factor Development

	Portion of Year Wage Applies	Clerks and Mailhandlers	City Delivery Carriers	
PFY 1998 Average Hourly Rate	100.0%	\$16.05	\$16.99	[1]
PFY 1999 Average Hourly Rate	100.0%	\$16.55	\$17.12	[2]
PFY 1999 Cost-Level Factor		1.031	1.007	[3]
PFY 1999 AP13 Average Hourly Rate		\$16.81	\$17.13	[4]
COLA using July 1999 trigger on 9/11/1999		\$0.17	\$0.17	[5]
Average Hourly Rate with 9/11/1999 Increase	19.2%	\$16.97	\$17.29	[6]
11/20/1999 General Wage Increase		1.4%	1.4%	[7]
Average Hourly Rate with 11/20/1999 Increase	30.8%	\$17.21	\$17.54	[8]
COLA using January 2000 trigger on 3/11/2000		\$0.13	\$0.13	[9]
Average Hourly Rate with 3/11/2000 COLA	50.0%	\$17.34	\$17.67	[10]
PFY 2000 Average Hourly Rate	100.0%	\$17.23	\$17.56	[11]
PFY 2000 Cost-Level Factor		1.041	1.026	[12]

[1] National Payroll Hours Summary Report PFY 1998, AP 13 year-to-date figures for straight time hours on line 1: page 27 for Clerk, page 54 for Special Delivery Messenger, page 33 for Mailhandler, and page 40 for City Delivery Carrier.

[2] National Payroll Hours Summary Report PFY 1999, AP 13, year-to-date figures for straight time hours on line 1: page 27 for Clerk/Special Delivery, page 33 for Mailhandler, and page 40 for City Delivery Carrier.

[3] = [2] / [1]

[4] National Payroll Hours Summary Report PFY 1999, AP 13, current period figures for straight time hours on line 1: page 27 for Clerk/Special Delivery, page 33 for Mailhandler, and page 40 for City Delivery Carrier.

[5] Exhibit 1, column 6.

[6] = [4] + [5]

[7] APWU, NPMHU, and NALC labor agreements.

[8] = [6] + ([6] x [7])

[9] Exhibit 1, column 6.

[10] = [8] + [9]

[11] Weighted Average of [6], [8], and [10] using weights from Portion of Year Wage Applies column.

[12] = [11] / [2]

Exhibit 3. Transportation Average Cost Index Development

FY	Calendar Year Quarters	Trucking Operations Cost Index [1]	Private Transportation Cost Index [2]
1998	1997:4	1.114	1.405
1998	1998:1	1.130	1.384
1998	1998:2	1.132	1.381
1998	1998:3	1.146	1.375
1998	Average	1.131	1.386
1999	1998:4	1.154	1.376
1999	1999:1	1.169	1.363
1999	1999:2	1.173	1.400
1999	1999:3	1.188	1.418
1999	Average	1.171	1.389
2000	1999:4	1.191	1.447
2000	2000:1	1.204	1.453
2000	2000:2	1.211	1.459
2000	2000:3	1.216	1.451
2000	Average	1.206	1.453

[1] DRI projections, PPI4213NS series.

[2] DRI projections, CUSAT1NS series.

Exhibit 4. Transportation Cost-Level Factor Development

FY	Average Trucking Operations Cost Index [1]	Trucking Operations Cost-Level Factor [2]	Average Private Transportation Cost Index [3]	Private Transportation Cost-Level Factor [4]
1998	1.131		1.386	
1999	1.171	1.036	1.389	1.002
2000	1.206	1.029	1.453	1.046

[1] Average figures taken from [1] in Exhibit 3.

[2] Ratio of current year to past year in [1].

[3] Average figures taken from [2] in Exhibit 3.

[4] Ratio of current year to past year in [3].

Exhibit 5. BPRS Unit Costs

Cost Component	Revised FY				Unit Cost (cents)	Factor	Unit Cost (cents)	Factor	Unit Cost (cents)	Factor
	FY 1998	1998 Unit Cost	FY 1999	FY 1999 Cost-Level						
Collection	4.4	4.3	1.031	4.4	1.041	4.6				
Mail Processing	48.1	59.4	1.031	61.2	1.041	63.8				
Transportation	33.7	33.7	1.036	34.9	1.029	35.9				
Delivery	2.4	2.4	1.031	2.5	1.041	2.6				
Postage Due	4.4	4.0	1.031	4.1	1.041	4.3				
Total	93.0	103.8		107.2		111.2				

[1] Table 3 Summary of Unit Costs, Bulk Parcel Return Service Cost Study, Oct 30, 1998, p 7.
 [2] USPS revisors to [1] to comport with mail processing costing methodology adopted by the Commission in R97-1.
 [3] Collection, Mail Processing, Delivery, and Postage Due from Clerks and Mailhandlers column of Exhibit 2.
 [4] Transportation from Trucking Operations Cost-Level Factors column of Exhibit 4.
 [5] Revised 1998 Unit Cost column x 1999 Cost-Level Factor column.
 [6] 1999 Unit Cost column x 2000 Cost-Level Factor column.

CERTIFICATE OF SERVICE

This will certify that the foregoing Direct Testimony of Lawrence G. Buc was served on December 17, 1999, by first class mail, on the following:

Daniel J. Foucheaux, Jr.
Chief Counsel, Ratemaking
United States Postal Service
475 L'Enfant Plaza West, S.W.
Washington, DC 20260-1145

Timothy J. May, Esq.
Patton Boggs LLP
2550 M Street, NW
Washington, DC 20037-1350

John M. Burzio
Burzio & McLaughlin
Canal Square, Suite 540
1054 31st Street, N.W.
Washington, DC 20007-4403

Mr. Pierce Myers
Executive Vice President
Parcel Shippers Association
1211 Connecticut Ave, NW
Suite 610
Washington DC 20036

James R. O'Brien
Director, Distribution & Postal Affairs
Time, Inc.
Time & Life Building, 38th Floor
Rockefeller Center
New York, NY 10020-1393

N. Frank Wiggins
Venable, Baetjer, Howard
& Civiletti, LLP
1201 New York Avenue, NW
10th Floor
Washington DC 20005

John E. McKeever
Piper & Marbury, L.L.P.
2400 Two Logan Square
18th & Arch Streets
Philadelphia, PA 19103-2762


Gene Del Polito
Advertising Mail Marketing
Association
1901 N. Fort Myers Drive
Arlington, VA 22209-1609

Linda Shepherd
United Parcel Service
Corporate Strategy Group
55 Glenlake Parkway, NE
Atlanta, GA 30328-3498

Lawrence G. Buc
Project Performance Corp.
7600 Colshire Drive
McLean, VA 22102-7603

Dana T. Ackerly, Esq.
Covington & Burling
1201 Pennsylvania Ave, NW
PO Box 7566
Washington, DC 20044-7566

Mark L. Pelesh
John R. Przepyszny
Drinker Biddle & Reath LLP
1500 K Street NW
Suite 1100
Washington DC 20005


Aaron Horowitz