CSA-T-1

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

POSTAL RATES AND FEE CHANGES

DOCKET NO. R2000-1

DIRECT TESTIMONY OF
LAWRENCE G. BUC
ON BEHALF OF THE
CONTINUITY SHIPPERS ASSOCIATION,
DIRECT MARKETING ASSOCIATION,
ASSOCIATION FOR POSTAL COMMERCE,
AND PARCEL SHIPPERS ASSOCIATION

Dated: May 19, 2000

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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 co-direct a practice that focuses on economic and cost analysis, usually in a postal or environmental context. I am also responsible for the overall finances of the firm.

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 am a member of the American Economic Association.

I have participated in United States Postal Service (USPS or Postal Service) rate and classification cases for over 25 years. I joined the Revenue and Cost Analysis Division of the Postal Service in March of 1975 and have analyzed postal issues ever since. I have worked not only for the Postal Service, but also for the United States Postal Rate Commission (the Commission) and private clients with interests in postal topics. I have been involved in seven previous omnibus rate cases: Docket Nos. R74-1, R76-1, R77-1, R84-1, R87-1, R90-1, and R97-1.

This is the seventh case in which I have submitted testimony to the Commission. In Docket Nos. R84-1, R90-1, and R97-1, I appeared as a witness for intervenors before the Commission; in Docket No. MC76-1, I appeared as a witness for the Postal Service; and in Docket No. MC77-2, I appeared as a witness for the Office of the Consumer Advocate. I also appeared as a witness for the complainant in Docket No. C99-4.

I. PURPOSE AND SCOPE OF TESTIMONY

My testimony analyzes the costs and pricing of the Bulk Parcel Return Service (BPRS). The first section analyzes the unit attributable costs for BPRS and shows that the Postal Service overstates these costs by at least 11.6 cents. Thus, I estimate the unit cost of BPRS should be no more than 98.9 cents (without contingency), rather than the $1.105 estimated by Postal Service witness Eggleston (USPS-T-26 at 40). The second section provides an analysis of the pricing factors. From my analysis, I conclude that the cost coverage for BPRS should be 132.9 percent, the same as for Standard A Regular, rather than the 146 percent coverage as proposed by Postal Service witness Mayo (USPS-T-39 at 15). Based on a unit cost of 99.9 cents (including a one percent contingency) and a coverage of 132.9 percent, I conclude that the BPRS fee should be $1.33 (after rounding to the nearest cent) per return rather than the $1.65 as proposed by witness Mayo (USPS-T-39 at 15).

II. ATTRIBUTABLE COSTS FOR BULK PARCEL RETURN SERVICE

Witness Eggleston estimates Test Year 2001 unit costs for BPRS. To do so, she estimates costs in five different cost components: collection, mail processing, transportation, delivery, and postage due. USPS-T-26 at 31. According to her analysis, the Test Year unit cost for BPRS (without contingency) is 110.5 cents in the Test Year. USPS-T-26 at 40.

Witness Eggleston concedes that "...most of the assumptions are made in a manner that has more potential to overstate rather than understate costs." USPS-T-26 at 32. In the following sections of this testimony, I will show that she has overestimated costs by 11.6 cents: 1.2 cents in collection, 6.6 cents in mail processing, and 3.8 cents in transportation. Table 1, below, summarizes the unit costs I calculate and those calculated by witness Eggleston in these three components. I have accepted the Postal Service's unit costs for delivery and postage due.

TABLE 1. BPRS UNIT COST COMPARISON

(costs rounded to nearest tenth of a cent)

Cost Component	CSA Unit Cost (cents)	USPS Unit Cost (cents)[1]	Difference (cents)
Collection	2.1[2]	3.2	(1.2)
Mail Processing	50.5[3]	57.1	(6.6)
Transportation	38.5[4]	42.3	(3.8)
Delivery	3.3	3.3	-
Postage Due	4.6	4.6	-
Total (w/o contingency)	98.9	110.5	(11.6)

Detail may not sum to total due to independent rounding
1 USPS-T-26 at 40.
2 CSA -T-1 at 3.
3 CSA -T-1 at 6 and 7.
4 CSA -T-1 at 7 and 8.

A. Collection

Witness Eggleston's cost estimate includes 1.16 cents per piece for window acceptance in the collection cost component. USPS-T-26, Attachment S.[1] She states that the window service costs are a proxy from the single piece Standard A collection costs from BY98. USPS-T-26 at 32. Window acceptance costs for the single piece Standard A rate category include the costs of weighing, rating, and collecting postage. A window clerk, however, does not perform those activities for BPRS. Instead, they are performed in bulk at the postage due unit.

In fact, witness Eggleston found that these same activities do not incur any additional costs with the Merchandise Return Service label:

> To return a parcel to mailer, the customer simply puts the mailer-supplied MRS label on the parcel and places the parcel into the mailstream. Weighing and rating is performed at the postage due unit in the destination postal facility. Since the parcel does not need to be weighed and rated at the window, window service acceptance is no longer a requirement of MRS. USPS-T-26 at 41.

Therefore, the collection costs for BPRS should be reduced by 1.16 cents, from 3.22 cents to 2.06 cents. Including the weighing and rating costs for BPRS in collection as well as postage due double counts these costs.

[1]The attachment shows cost of $1,736,287 and volumes of 150,276,000 pieces.

B. Mail Processing

Witness Eggleston developed Test Year unit mail processing costs for BPRS using the model she used to develop costs for non-dropshipped Parcel Post and for single-piece Special Standard mail. To reflect the "unique characteristics" of BPRS, she modified inputs to the model in six ways:

1. Changed average cube and weight to reflect BPRS
2. Assumed 100 percent machineability
3. Assumed no bed loaded parcels
4. Used Special Standard CRA adjustment
5. Modified mailflow to reflect BPRS mailflow
6. Assumed inter and intra BMC weights

I believe four of these modifications are appropriate. Reflecting the cube and weight differences between Special Standard B and BPRS, modeled unit costs for BPRS are only 70 percent of those for Special Standard B. Tr. 13/5204 (Eggleston) However, the fourth and the sixth modifications overestimate BPRS costs.

Special Standard CRA Adjustment

Witness Eggleston explains the need for a CRA adjustment to modeled costs: "CRA adjustment factors are used to tie the modeled costs to the costs reported in the Cost and Revenue Analysis Report (CRA)." USPS-T-26 at 5. There are two types of CRA adjustment factors: proportional and fixed. "Proportional cost pools are those cost pools that are included in the model. Fixed cost pools are those cost pools that are not included in the model. Fixed cost pools are not included in the model for one of two reasons. Either the fixed cost pool is not worksharing-related or the cost pool is not parcel-related." USPS-T-26 at 5.

For BPRS, witness Eggleston used the proportional Special Standard CRA adjustment factor, which is 1.042. USPS-T-26, Attachment P at 1. She multiplied her weighted average mail processing modeled cost for BPRS, $.345, by the proportional CRA adjustment factor of 1.042. USPS-T-26, Attachment T at 1. This adds 1.449 cents

to her modeled cost. Then she added the fixed adjustment of $.211 for Special Standard to produce mail processing costs of $.571. USPS-T-26, Attachment T at 1.

Because the fixed CRA adjustment represents almost 37 percent of BPRS mail processing costs, I examined the cost pools in which the costs of the Special Standard fixed adjustment occur. The cost pools appear to fall into two different categories: those in which costs are expected and those in which they are not.

Activities in the "expected" cost pools, like the SPBS or the pouching pools, should be affected by cube and weight to the same degree that these factors affect "proportional cost pools". Since witness Eggleston confirmed that differences in the cube and weight of BPRS lead to its modeled costs being about 70 percent of the modeled cost of Special Standard B (Tr. 13/5204 (Eggleston)), the "expected" cost pools should similarly have a fixed CRA adjustment that is 70 percent of the Special Standard B fixed CRA adjustment.

Costs for other cost pools in the fixed adjustment cost pools, like the BCS, FSM, or registry are "unexpected". When asked about these apparent anomalies, witness Eggleston responded, "It is my understanding that occasionally costs show up in cost pools where they are unexpected. It is my further understanding that the reason for this is the following. The IOCS handling tallies record the mail actually being handled by the employees recorded as working a given mail processing operation (cost pool), rather than the mail expected to be handled in a given operation." Tr.13/5128 (Eggleston)

Thus, if an employee was clocked into the BCS cost pool, and received a Special Standard B tally, that employee was most likely handling Special Standard mail. And, if he was actually handling Special Standard B mail, it is much more likely that he was actually handling it in a way that witness Eggleston modeled rather than putting it through a bar code sorter. Given that the differences in the cube and weight of BPRS lead to its modeled costs being about 70 percent of the modeled cost of Special Standard B, then the "unexpected" cost pools should also have a fixed CRA adjustment of 70 percent of the Special Standard B fixed CRA adjustment.

Since costs in both types of "fixed" pools appear to be affected by cube and weight, it is appropriate to use a fixed CRA adjustment that is 70 percent of the Special

Standard fixed CRA adjustment. Therefore, the fixed adjustment for BPRS should be 14.790 cents, 6.34 cents less than witness Eggleston's fixed CRA adjustment.

Inter and Intra BMC Weights

Based upon the assumption that all BPRS recipients receive returns on a national basis, witness Eggleston assumes that 95.2 percent of BPRS parcels are inter-BMC parcels and the other 4.8 percent are intra-BMC parcels. USPS-T-26 at 35. This assumption is clearly incorrect since one of the eight recipients surveyed did not receive returns on a national basis. USPS-T-26 at 35.

To correct this mistake, I assume that all of the parcels received by this mailer (which was 3.5 percent of **all** BPRS parcels) rather than only 4.8 percent of **this mailer's** parcels, are intra-BMC parcels. Thus, rather than 95.2 percent of BPRS being intra-BMC, only 91.9 percent are. Since the mail processing cost difference is 8.7 cents between intra-BMC and inter-BMC parcels, this reduces BPRS mail processing costs by 0.3 cents. Tr. 13/5122 (Eggleston).

C. Transportation

Consistent with her general costing approach, witness Eggleston overstated transportation costs by making two erroneous assumptions. First, she assumed that the zone distribution of inter-BMC BPRS parcels is the same as that for inter-BMC Parcel Post parcels, thus overstating zone related transportation costs. USPS-T-26 at 36. Second, she assumed that only one out of every 21 BPRS parcels is intra-BMC. In this section, I quantify the extent to which these assumptions overstate unit transportation costs for BPRS. In all, I find that her assumptions overstate BPRS costs by 3.8 cents.

Inter-BMC Parcel Zone Distribution

To develop transportation costs, witness Eggleston assumed that the zone distribution for inter-BMC BPRS parcels is the same as that for Standard (B) Parcel Post inter-BMC parcels. This is clearly wrong. While 23 percent of Parcel Post cubic feet are sent to Zones 6-8 (USPS-T-26, Attachment L at 7) 61 percent of BPRS volume is returned to four mailers that "are located in an area that will rarely use zones above zone 5." USPS-T-26 at 37; Tr. 13/5114 (Eggleston). Therefore, for the zone distribution

of inter-BMC BPRS to be similar to the zone distribution of inter-BMC Parcel Post, the other four mailers (which receive 39 percent of BPRS volume) would have to receive the majority of their volume from Zones 6-8. This is extremely unlikely.

Because half of BPRS recipients will rarely use zones above zone 5, assuming that no BPRS recipients use zones above zone 5 is just as reasonable as witness Eggleston's assumption. Because this assumption results in lower bound transportation cost estimates and witness Eggleston's assumption results in upper bound transportation cost estimates, I developed estimates of zone-related inter-BMC transportation costs based on these two assumptions and then averaged them to determine BPRS zone-related inter-BMC transportation costs. As detailed in Attachment A, this average zone-related transportation cost for inter-BMC BPRS parcels is 3.1 cents less than the Postal Service's cost estimate.

Based upon the Postal Service's assumption that 95.2 percent of BPRS parcels are inter-BMC parcels, USPS-T-26 at 37, this improved estimate reduces unit transportation costs for all BPRS parcels by 3.0 cents. Using the 91.9 percent figure that I developed above, this translates into a 2.9-cent reduction in unit BPRS costs.

Inter and Intra BMC Weights

As discussed above, witness Eggleston assumes that 95.2 percent of BPRS parcels are inter-BMC parcels and the other 4.8 percent are intra-BMC parcels. USPS-T-26 at 35. I believe that the appropriate figure is 91.9 percent. Since the unit transportation cost difference is 27.6 cents between intra-BMC and inter-BMC parcels, Tr. 13/5122 (Eggleston), this correction reduces unit BPRS transportation costs by 0.9 cents.

III. COST COVERAGE/PRICING

The appropriate cost coverage for BPRS has not been reviewed within the context of an omnibus rate case. The current cost coverage of 156 percent was set in Docket No. MC97-4 as part of a negotiated settlement. The BPRS rate was not reviewed in Docket No. R97-1 because BPRS was a new service and the Postal Service was conducting a cost study as required by Docket No. MC97-4. The Commission also did not review cost coverage for BPRS in Docket No. C99-4.

I have reviewed the Postal Service's proposed cost coverage in this case for BPRS in relation to the policies of Title 39 and the nine factors stated in §3622(b). In this case, witness Mayo proposes a cost coverage for BPRS of 146 percent. USPS-T-39 at 15. My review of the Title 39 policies and the nine factors shows that this proposed cost coverage for BPRS is too high. The cost coverage should be 132.9 percent, which is the coverage applied to Standard A Regular mail. My analysis supporting these conclusions is set forth below.

Factor 1, "fairness and equity", is the foundation for all of the other factors and provides the basis for balancing them. §3622(b)(1). The proposed BPRS coverage is not fair and equitable. The Postal Service's proposed coverage is overstated in relation to the coverage on other similar return services, i.e. Bound Printed Matter and to the coverage applied to the parcels on their outgoing leg that become BPRS. Furthermore, as described above, the intention of the Postal Service's cost study was to overstate costs. USPS-T-26 at 32. This is neither fair nor equitable.

Factor 2, "value of the service," looks at the inherent worth of the service provided to the sender and recipient. §3622(b)(2). The Postal Service often considers price elasticity of demand in this factor, but there is not an estimate of demand elasticity for BPRS. Thus, the determination of value must be more subjective.

The value of the BPRS service is much lower than the value indicated by the Postal Service's proposed cost coverage. BPRS receives low priority in terms of transportation and processing and only ground transportation is used. There is no service standard for BPRS, so it has low priority of delivery. Further, the Postal Service determines "how often the bulk parcels are delivered or how often the mailer may pick up the bulk parcels." USPS-T-39 at 16. Thus, the mailer is not guaranteed delivery six days a week since the Postal Service controls the timing and frequency of the actual return of the parcels.

For other similar return services, such as Bound Printed Matter, the Postal Service is proposing much lower cost coverages. For Bound Printed Matter, the Postal Service is proposing a coverage of 117.6 percent. 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." Op. R97-1 at 434. In fact, Bound Printed Matter provides a greater value in that the Postal Service delivers Bound Printed Matter returns to the company. In comparison, one-half of BPRS recipients pick up their BPRS returns.

Although BPRS is a special service, the Postal Service's implementing regulations for the BPRS return label treat it as Standard A Regular mail. The "class of mail" endorsement required by the Postal Service for the BPRS return label is "Standard Mail (A)." Fed. Reg. Vol. 64, No. 180, September 17, 1999, p. 50452. The "Standard Mail (A)" endorsement is needed because it informs postal employees the processing requirements of BPRS mail.

The value of the BPRS service is even lower than the value of the outgoing parcel under Standard A Regular mail. On the outgoing Standard A leg, value is at its highest because, at that time, the outgoing leg represents the successful closing of a sale. By comparison, on its return BPRS leg, the value of the service is low because the return 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 show that in 73 percent of the returns, the customer cancels her membership; conversely, in only 27 percent of the returns does the customer continue her membership. In short, almost three quarters of the time, the BPRS return marks the conclusion of a business relationship.

The value of the BPRS service has not increased as a result of the recent minor modification allowing the return of opened parcels. 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 in Table 2, below.

Table 2. BPRS RETURNS

	Opened (percentage)	Unopened (percentage)
1997	56.0	44.0
1998	54.4	45.6
1999 (Nov)	53.6	46.4

As the table shows, the minor modification to BPRS to include opened returns, did not affect the Postal Service's actual handling of returns: the Postal Service has always returned the parcels even if they were opened. The current BPRS service 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.

Merchandise mailers who use other mail classifications also receive opened/resealed parcel returns even if the classifications do not technically allow for it. For example, companies who mail out music on tapes and CDs Standard A mail, but receive their returns as Special Standard B, also receive opened/resealed returned parcels.

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: they must process the returns and restock 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.

Another company 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 about 30 percent more when re-introduced to inventory after being returned 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 shows the substantial costs for reusing returned product. Further, while there is some value to the company

of the return through re-use of the return product, that value is significantly less than the profit made from successful sales.

The return of the product not only benefits mailers, but also benefits 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 at12.

Factor 3 requires that mail "bear the direct and indirect postal costs attributable" to it and contribute to institutional costs.. §3622(b)(3). A BPRS fee of $1.33 would more than meet the requirement. At this fee, BPRS provides a contribution of 33.1 cents (132.9 percent) to institutional cost.

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 BPRS. §3622(b)(4). BPRS was created to remedy a draconian increase in Third Class Single Piece rates (the predecessor to Standard A and the rate previously applied to these parcel returns) in Docket No. R94-1. In Docket No. R94-1, the Third Class Single Piece rate increased by an average of 66 percent 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), only five cents less than Priority Mail (for up to two pounds, air transportation within 2-3 day delivery). While BPRS provided rate relief to the general public and BPRS users, less expensive rates have a beneficial impact on both consumers and mailers.

Factor 5 considers the availability, at reasonable prices, of alternative services. §3622(b)(5). There is no economically realistic alternative to the Postal Service return of BPRS parcels, just as there is no realistic alternative to the outbound leg of Standard A mail. This factor favors lower BPRS rates.

Factor 6 looks at the reduction of costs to the Postal Service 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. This argues in favor of lower rates.

Factor 7 favors a straight forward fee structure. §3622(b)(7). Neither my proposed cost coverage nor witness Mayo's affects the per piece fee structure. Either would 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 132.9 percent.

Attachment A. Calculation of Unit BPRS Zone-Related Transportation Cost for Inter-BMC Parcels

Table 1. USPS Estimate

Zone	Zone Distribution	Zone-Related Cost Per Cubic Foot Per Inter-BMC Leg	BPRS	
			Weighted Zone-Related Cost per Cubic Foot Per Inter-BMC Leg	Unit Zone-Related Cost per Inter-BMC BPRS Parcel
	[1]	[2]	[3]=[1]*[2]	[4]=.08*[3]
1 or 2	9%	$0.4898	$0.044	$0.004
3	17%	$1.0725	$0.185	$0.015
4	28%	$1.9476	$0.545	$0.044
5	23%	$3.5758	$0.827	$0.066
6	11%	$5.2686	$0.553	$0.044
7	6%	$6.8505	$0.385	$0.031
8	6%	$10.1262	$0.646	$0.052
Total	100%	NA	$3.187	$0.255

[1] Proportions from USPS-T-26, Attachment L at 7, Column [1]

[2] USPS-T-26, Attachment N at 1, Column [3]

[4] USPS-T-26, Attachment U at 1: Average BPRS Cube=.08

Table 2. Zone 5 Cap Estimate

Zone	Zone Distribution	Zone-Related Cost Per Cubic Foot Per Inter-BMC Leg	BPRS	
			Weighted Zone-Related Cost per Cubic Foot Per Inter-BMC Leg	Weighted Zone-Related Cost per Inter-BMC BPRS Parcel
	[5]	[6]	[7]=[5]*[6]	[8]=.08*[7]
1 or 2	9%	$0.4898	$0.044	$0.004
3	17%	$1.0725	$0.185	$0.015
4	28%	$1.9476	$0.545	$0.044
5	46%	$3.5758	$1.632	$0.131
6	0%	$5.2686	$0.000	$0.000
7	0%	$6.8505	$0.000	$0.000
8	0%	$10.1262	$0.000	$0.000
Total	100%	NA	$2.407	$0.193

[5] Distribution from [1] with Zone 5 cap

[6] USPS-T-26, Attachment N at 1, Column [3]

[8] USPS-T-26, Attachment U at 1: Average BPRS Cube=.08

Table 3. CSA Estimate

Zone	Zone Distribution	Zone-Related Cost Per Cubic Foot Per Inter-BMC Leg	BPRS	
			Weighted Zone-Related Cost per Cubic Foot Per Inter-BMC Leg	Weighted Zone-Related Cost per Inter-BMC BPRS Parcel
	[9]	[10]	[11]=[9]*[10]	[12]=.08*[11]
1 or 2	9%	$0.4898	$0.044	$0.004
3	17%	$1.0725	$0.185	$0.015
4	28%	$1.9476	$0.545	$0.044
5	34%	$3.5758	$1.230	$0.098
6	5%	$5.2686	$0.277	$0.022
7	3%	$6.8505	$0.193	$0.015
8	3%	$10.1262	$0.323	$0.026
Total	100%	NA	$2.797	$0.224

[9] Average of Zone Distributions From Tables 1 and 2

[10] USPS-T-26, Attachment N at 1, Column [3]

[12] USPS-T-26, Attachment U at 1: Average BPRS Cube=.08

CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing Testimony of Lawrence G. Buc on all participants in this proceeding in accordance with section 12 of the Rules of Practice.

Dated: May 19, 2000

Aaron Horowitz