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POSTAL RATE COMMISSION
OFFICE OF THE SECRETARY

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

POSTAL RATE AND FEE CHANGES, 2000

Docket No. R2000-1

**DIRECT TESTIMONY
OF
ROGER C. PRESCOTT**

**On Behalf Of
MAIL ORDER ASSOCIATION OF AMERICA**

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Due Date: May 22, 2000

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Appendix A	Statement of Qualifications

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I. PURPOSE OF TESTIMONY

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In this current proceeding, the United States Postal Service's ("USPS") Witness James M.

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Kiefer (USPS-T-37) submitted proposed changes to the rates for Standard (B) Bound Printed

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Matter ("BPM") mail. These proposed rates, for the first time, include destination entry discounts

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for BPM mail. The cost savings for the destination entry discounts proposed by Witness Kiefer

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were based on the analyses presented by the USPS' Witness Charles L. Crum (USPS-T-27).

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I have been requested by the Mail Order Association of America ("MOAA") to review the

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direct testimony and underlying workpapers of the USPS' Witnesses Crum and Kiefer in order to

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evaluate the reasonableness of the destination entry discount for BPM mail entered at the

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Destination Delivery Unit ("DDU"). The results of my analyses are summarized under the

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following topics:

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II. Summary and Conclusions

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III. Discounts for BPM Entered at the DDU

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II. SUMMARY AND CONCLUSIONS

Based on my review and analysis of the USPS' proposed rates for BPM and the proposed discounts for BPM mail entered at the DDU, I conclude the following:

1. The calculation of the cost savings for BPM mail entered at the DDU as presented by the USPS in this proceeding equal \$0.661 per piece and \$0.088 per pound;
2. The USPS' proposed discount for BPM mail entered at the DDU equals \$0.297 per piece which reflects a passthrough of 45 percent of the cost savings. The USPS' proposed discount per pound for BPM mail entered at the DDU equals \$0.031 per pound which represents a passthrough of 35 percent of the cost savings; and,
3. Any passthrough of less than 100 percent of the cost savings results in a higher contribution to the USPS' institutional costs. The USPS goal in this proceeding is to better align rates with costs by proposing discounts which will encourage worksharing. While some uncertainty may exist regarding the level of the cost savings for the destination entry discounts, a modest increase in the passthrough percentage will serve to mitigate the large rate increase proposed for BPM mail entered at the DDU. Therefore, for this proceeding I propose that the passthrough for BPM mail entered at the DDU should be increased to 50 percent of the cost savings. When the passthrough is set to 50 percent, the discounts for BPM mail entered at the DDU equal \$0.331 per piece and \$0.044 per pound.

III. DISCOUNTS FOR BPM ENTERED AT THE DDU

In his testimony and workpapers, the USPS' Witness Crum summarizes the cost savings related to the dropshipping of BPM mail. The cost savings developed by Witness Crum were then used by Witness Kiefer to calculate discounts separately on a per piece basis and a per pound basis.^{1/} Table 1 below summarizes the destination entry cost savings for BPM mail entered at the DDU provided by Witness Crum and utilized by Witness Kiefer:

Table 1 Summary of Cost Savings for BPM Mail Entered at the DDU			
Item	Per Piece ^{1/}	Per Pound ^{2/}	
(1)	(2)	(3)	
1. Cost Savings for Mail Entered at DDU	\$0.661	\$0.088	
^{1/} USPS-T-27, Attachment I, Table 3 (revised 04/14/00) and page 17.			
^{2/} Tr. 13/5286.			

For BPM mail entered at the DDU, the cost savings equal \$0.661 per piece and \$0.088 per pound.

Based on these cost savings, Witness Kiefer developed his proposed destination entry discounts. Table 2 below compares the cost savings in Table 1 above with Witness Kiefer's proposed discounts. The passthrough percentage (Table 2, Line 3) is the ratio of the proposed discount to the cost savings.

^{1/} On April 14, 2000, Witness Crum provided an errata which increased his cost savings for mail entered at the Bulk Mail Center ("BMC") from \$0.380 per pound to \$0.385 per pound. When this revision is added to the cost savings (relative to the BMC) for BPM entered at the DDU of \$0.276 per pound, the total cost savings equal \$0.661 per pound.

Table 2
**Comparison of Cost Savings, Proposed Discounts
 and Passthrough Percentage for
 BPM Mail Entered at the DDU**

<u>Item</u> (1)	<u>Amount</u>	
	<u>Per Piece</u> (2)	<u>Per Pound</u> (3)
1. Cost Savings ^{1/}	\$0.661	\$0.088
2. Proposed Discounts ^{2/}	\$0.297	\$0.031
3. Passthrough Percentage ^{3/}	45%	35%

^{1/} Table 1 above.
^{2/} Library Reference LR-I-325, WP-BPM-28 as summarized in Tr. 13/5286.
^{3/} Line 2 ÷ Line 1.

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15 For BPM mail entered at the DDU, Witness Kiefer has proposed discounts of \$0.297 per
16 piece and \$0.031 per pound (Table 2, Line 2). The passthrough of the cost savings for BPM mail
17 entered at the DDU equals 45 percent for the per piece portion of the rate and 35 percent for the
18 per pound portion of the rate (Table 2, Line 3).

19 This is the first time that the USPS has proposed destination entry discounts for BPM mail.
20 As noted by Witness Kiefer “[t]aking advantage of these drop-ship discounts will, in many cases,
21 also help mitigate the net impact of the rate increases.” ^{2/} The proposed discounts are “designed
22 to recognize that the Postal Service enjoys cost and processing savings when mailers enter their

^{2/} USPS-T-37, page 3.

1 mail close to its delivery destination." ^{3/} In addition, the institution of destination entry discounts
2 "should send appropriate price signals that encourage these cost saving practices". ^{4/}

3 Witness Kiefer justifies a passthrough percentage less than 100 percent "...in case the proxy
4 cost savings turn out to be overly optimistic" ^{5/}. For mail entered at the DDU, the difference
5 between the cost savings and discounts equals \$0.364 per piece and \$0.057 per pound (Table 2,
6 Line 1 - Line 2). This differential between the cost savings and the proposed discount provides
7 a substantial increase in the contribution to the USPS' institutional costs and a wide margin of
8 error for the USPS.

9 I have three comments regarding the USPS' proposed use of a conservative passthrough
10 percentage. First, the use of a passthrough percentage of less than 100 percent of the cost savings
11 will result in the USPS having a higher contribution to institutional costs for the mail utilizing the
12 dropshipping than mail that does not use this option. This does not conform to the USPS goal to
13 "better align rates with the costs of transporting, processing and delivering Bound Printed
14 Matter". ^{6/} Second, in light of the large increase in the rates for BPM mail entered at the DDU,
15 I believe that for this proceeding a larger passthrough of the cost savings to "encourage these cost
16 saving practices" is warranted. Therefore, I propose a passthrough of 50 percent of the cost
17 savings for BPM mail entered at the DDU. Such a modest change from the passthrough
18 percentage proposed by the USPS will not create major changes in the rates for BPM mail.

^{3/} USPS-T-37, page 33.

^{4/} USPS-T-37, page 34 (footnote omitted).

^{5/} USPS-T-37, page 39.

^{6/} USPS-T-37, page 33.

1 Finally, nothing has been presented in this proceeding to indicate that the calculated cost savings
 2 are overstated. However, even if the cost savings for BPM mail entered at the DDU are
 3 overstated, a 50 percent passthrough still leaves a wide margin of error.

4 Table 3 below calculates the destination entry discounts for BPM mail entered at the DDU
 5 based on my proposed passthrough percentage of 50 percent.

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Table 3 Calculation of Discounts for BPM Mail Entered at the DDU Based on Passthrough of 50% of the Cost Savings				
Item	Source	Amount		
		Per Piece	Per Pound	
(1)	(2)	(3)	(4)	
1. Cost Savings for Mail Entered at DDU	Table 1, Line 1	\$0.661	\$0.088	
2. Proposed Passthrough Percentage of 50%	See Text	<u>0.50</u>	<u>0.50</u>	
3. Revised Discount for BPM Mail Entered at DDU	Line 1 x Line 2	\$0.331	\$0.044	
4. USPS Proposed Discount for BPM Mail Entered at DDU	Table 2, Line 2	<u>0.297</u>	<u>0.031</u>	
5. Change in Discount	Line 3 - Line 4	\$0.034	\$0.013	

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17 If the passthrough of the cost savings for BPM mail entered at the DDU is increased to 50
 18 percent, the discounts for BPM mail entered at the DDU equal \$0.331 per piece and \$0.044 per
 19 pound (Table 3, Line 3). These revised discounts reflect an increase over the discounts proposed
 20 by the USPS' Witness Kiefer of \$0.034 per piece and \$0.013 per pound (Table 3, Line 5). Based
 21 on the revised discounts shown in Table 3 above, 50 percent of the cost savings will go towards
 22 the contribution to institutional costs. Also, the per unit (i.e., per piece or per pound) differential
 23 between cost savings and proposed discount is larger for BPM mail entered at the DDU than the

1 per unit differential for BPM mail entered at the destination Sectional Center Facility ("SCF") or
2 destination Bulk Mail Center ("BMC"). In summary, a 50 percent passthrough of the cost savings
3 for BPM mail entered at the DDU will provide incentives for mailers to perform worksharing
4 activities and better align the rates for BPM mail entered at the DDU with the costs incurred by
5 the USPS for that mail.

STATEMENT OF QUALIFICATIONS

My name is Roger C. Prescott, I am Executive Vice President and an economist with the economic consulting firm of L. E. Peabody & Associates, Inc. The firm's offices are located at 1501 Duke Street, Suite 200, Alexandria, Virginia 22314.

I am a graduate of the University of Maine from which I obtained a Bachelor's degree in Economics. Since June 1978 I have been employed by L. E. Peabody & Associates, Inc.

I have previously participated in various Postal Rate Commission ("PRC") proceedings. In Docket No. R90-1, Postal Rate And Fee Changes, 1990, I developed and presented evidence to the PRC which critiqued and restated the direct testimony of the United States Postal Service ("USPS") as it related to the development of the proposed rate structure on behalf of third class business mailers. I submitted rebuttal testimony in PRC Docket No. MC95-1, Mail Classification Schedule, 1995 Classification Reform I, regarding recommendations of intervenors in response to the USPS' proposed reclassification of Third Class Bulk Rate Regular ("TCBRR") rate structure. I also submitted rebuttal testimony in Docket No. 97-1, Postal Rate and Fee Changes, 1997 regarding the development of rates for Standard (A) mail. In Docket No. MC98-1, Mailing Online Service, I submitted testimony regarding the USPS' proposed service and the impact of that service on competition.

The firm of L. E. Peabody & Associates, Inc., specializes in solving economic, marketing and transportation problems. As an economic consultant, I have participated in the direction and organization of economic studies and prepared reports for railroads, shippers, for shipper

associations and for state governments and other public bodies dealing with transportation and related economic problems. Examples of studies which I have participated in organizing and directing include traffic, operational and cost analyses in connection with the transcontinental movement of major commodity groups. I have also been involved with analyzing multiple car movements, unit train operations, divisions of through rail rates and switching operations throughout the United States. The nature of these studies enabled me to become familiar with the operating and accounting procedures utilized by railroads in the normal course of business.

In the course of my work, I have become familiar with the various formulas employed by the the Surface Transportation Board ("STB"), which was formerly known as Interstate Commerce Commission ("ICC"), in the development of variable costs for common carriers with particular emphasis on the basis and use of Rail Form A and its successor, the Uniform Railroad Costing System ("URCS"). In addition, I have participated in the development and analysis of costs for various short-line railroads.

Over the course of the past twenty-two (22) years, I have participated in the development of cost of service analyses for the movement of coal over the major eastern, southern and western coal-hauling railroads. I have conducted on-site studies of switching, detention and line-haul activities relating to the handling of coal. I developed the carrier's variable cost of handling various commodities, including coal, in numerous proceedings before the ICC/STB. As part of the variable cost evidence I have developed and presented to the ICC/STB, I have calculated line specific maintenance of way costs based on the Speed Factored Gross Ton ("SFGT") formula.

I have developed and presented evidence to the ICC/STB related to maximum rates, and "Long-Cannon" factors in several proceedings. I have also submitted evidence on numerous occasions in Ex Parte No. 290 (Sub-No. 2), Railroad Cost Recovery Procedures related to the proper determination of the Rail Cost Adjustment Factor.

In the two recent Western rail mergers, Finance Docket No. 32549, Burlington Northern, et al. -- Control and Merger -- Santa Fe Pacific Corporation, et al. and Finance Docket No. 32760, Union Pacific Corporation, et al. -- Control and Merger -- Southern Pacific Rail Corporation et al., I reviewed the railroads' applications including their supporting traffic, cost and operating data and provided detailed evidence supporting requests for conditions designed to maintain the competitive rail environment that existed before the proposed mergers.