

E-STAMP-T-2

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

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POSTAL RATE COMMISSION
OFFICE OF THE SECRETARY

POSTAL RATE AND FEE CHANGES, 2000

Docket No. R2000-1

**DIRECT TESTIMONY
OF
ROGER C. PRESCOTT**

**On Behalf Of
E-STAMP CORPORATION**

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<u>ITEM</u> (1)	<u>TITLE</u> (2)
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DIRECT TESTIMONY**OF****ROGER C. PRESCOTT**

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4 My name is Roger C. Prescott. I am Executive Vice President of the economic consulting
5 firm of L. E. Peabody & Associates, Inc. The firm's offices are located at 1501 Duke Street,
6 Suite 200, Alexandria, Virginia 22314. I presented testimony before the Postal Rate Commission
7 ("PRC") regarding Third Class Bulk Regular ("TCBRR") or Standard (A) commercial mail rates
8 in Docket No. R90-1, Postal Rate and Fee Changes, 1990 ("R90-1"), Docket No. MC95-1, Mail
9 Classification Schedule, 1995 Classification Reform I ("MC95-1") and Docket No. R97-1, Postal
10 Rate and Fee Changes, 1997 ("R97-1"). I also presented testimony before the PRC regarding the
11 impact of the proposed mail service in Docket No. MC98-1, Mailing Online Service ("MC98-1").
12 In addition, I have on numerous prior occasions presented evidence before the Surface
13 Transportation Board (formerly the Interstate Commerce Commission) on economic ratemaking
14 and cost finding principles. My qualifications and experience are described in Appendix A to this
15 statement.

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I. PURPOSE OF TESTIMONY

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In this current proceeding, Docket No. R2000-1, Postal Rate and Fee Changes, 2000

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("R2000-1), the United States Postal Service ("USPS") has submitted proposed changes to the rates

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for First Class Mail. However, the rates proposed by the USPS do not consider the efficiencies

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and cost savings related to First Class Mail where the address, Facing Identification Mark

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("FIM"), barcode and postage are printed using computerized data, i.e., Information Based

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Indicia("IBI").

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I have been requested by E-Stamp Corporation to review the USPS' direct testimony and

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underlying workpapers to determine the cost savings related to the users of E-Stamp's software

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that prints automation-compatible barcodes on First Class mail pieces. I have also been asked to

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determine the passthrough percentage of the cost savings realized by the USPS for IBI mail if E-

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Stamp's proposed discount of four (4) cents per piece is accepted.

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The results of my analyses are summarized under the following topics:

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II. Summary and Conclusions

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III. Reasons for Discounts for IBI Mail

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IV. IBI Cost Savings for First Class Mail

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V. Passthrough Percentage for Proposed Discount

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II. SUMMARY AND CONCLUSIONS

Based on my review and analysis of the USPS' proposed rates in this proceeding and the underlying support for those proposed rates, I conclude the following:

1. IBI mail offers the USPS a new, low cost First Class mail product;
2. When compared to non-automation-compatible mail, automation-compatible IBI letter mail decreases the USPS' costs between 5.0 cents per piece and 6.2 cents per piece;
3. Automation-compatible IBI flat mail decreases mail processing costs by 5.1 cents per piece; and,
4. E-Stamp has proposed a 4.0 cent per piece discount for qualifying IBI letter mail. This proposed discount reflects a passthrough of the USPS' cost savings ranging between 65 percent and 80 percent.

1 **III. REASONS FOR DISCOUNTS FOR IBI MAIL**

2 In the past, the PRC has acknowledged that discounts should be given to recognize the cost
3 savings attributable to the mailer's preparation of automation-compatible mail. For example, in
4 R97-1 the PRC recognized that the USPS' "development of First Class worksharing proposals is
5 influenced by its interest in promoting automation."^{1/}

6 The development of IBI mail, such as presented by E-Stamp, is new and not included in
7 the costs that are developed as part of the USPS' Test Year After Rates ("TYAR") analysis. USPS'
8 Witness Fronk stated that the TYAR costs and volumes "do not make any assumption about mail
9 pieces using IBI indicia" (E-Stamp/ USPS-T33-2). Thus, the cost savings to the USPS for mail
10 prepared by the purchaser of E-Stamp's software are savings not in the current USPS analysis of
11 rates and costs for this proceeding. The passthrough of all of the cost savings for IBI mail as a
12 discount would not reduce this mail's contribution to the USPS' institutional costs. Further, E-
13 Stamp's proposal to passthrough only a portion of these savings as a discount will increase the
14 proposed rates' contribution to institutional costs for automation-compatible IBI mail.

15 Envelopes using the E-Stamp process of addressing mail include:

- 16 1. The postage based on IBI;
17 2. The Facing Identification Mark ("FIM");
18 3. Current address of the mail recipient; and,
19 4. 9-digit barcode.

^{1/} PRC's R97-1 decision dated May 11, 1998, page 291.

1 The E-Stamp addressed envelop presents a First Class mail piece that already reflects a
2 great deal of mail preparation and is automation-compatible. Thus, the type of cost savings as
3 developed by the USPS' Witnesses Michael W. Miller^{2/} and David G. Yacobucci^{3/} are relevant to
4 the cost savings inherent in the E-Stamp addressed envelope.

^{2/} USPS-T-24.

^{3/} USPS-T-25.

1 **IV. IBI COST SAVINGS FOR FIRST CLASS MAIL**

2 The USPS has not “prepare[d] a cost study that would indicate what the cost savings
3 associated with this mail [IBI] might be...”^{4/}. The USPS’ Witness Fronk admitted that the cost
4 data and underlying volume data presented by the USPS in this proceeding “do not make any
5 assumption about mail pieces using IBI indicia”^{5/}. However, because the USPS has developed
6 analyses of other First Class Mail to determine the cost savings related to automation-compatible
7 mail, these studies can be used as a surrogate for the cost savings related to IBI mail. The USPS
8 has developed the automation-related cost savings for First Class letters in Library Reference LR-
9 I-81 (“LR-I-81”) and in the testimony of USPS’ Witness Miller. The cost savings for First Class
10 flats are developed in the testimony of USPS’ Witness Yacobucci. My analysis of the cost savings
11 related to IBI mail is addressed under the following topics:

- 12 A. Cost Savings for Letters from LR-I-81
- 13 B. Cost Savings for Letters from Witness Miller
- 14 C. Cost Savings for Flats

15 **A. COST SAVINGS FOR**
16 **LETTERS FROM LR-I-81**

17 The USPS’ LR-I-81 developed the mail processing costs related to First Class letters. This
18 Library Reference calculated the cost differences for letters related to metered mail and Bulk
19 Metered Mail (“BMM”). For automation-compatible mail, LR-I-81 calculated the mail processing

^{4/} Stamps.com/USPS-T-33-2.

^{5/} E-Stamp/USPS-T-33-2.

1 costs for presorted letters. Because E-Stamp's IBI mail will be single piece, the savings related
2 to presortation are not applicable.^{6/} The determination of the automation-related cost savings
3 applicable to IBI letter mail was calculated in two (2) steps. First, I compared the mail processing
4 costs developed in LR-I-81 for presorted automation BMM with the costs for presorted non-
5 automation BMM. Next, because the BMM in LR-I-81 is subject to the economies due to
6 presortation, I excluded any cost differential related to the presortation by deducting the difference
7 in the mail processing costs between the presorted non-automated BMM and the single piece (non-
8 presorted) BMM. My analysis is summarized in Table 1 below.

^{6/} To qualify for presortation discounts under the USPS' proposal, the mailer must have 500 pieces of presorted mail.

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Table 1		
<u>Summary of Automation Cost Savings for Letters Based on LR-I-81</u>		
<u>Item</u>	<u>Source</u>	<u>Cost Per Piece (cents)</u>
(1)	(2)	(3)
<u>Presorted BMM</u>		
1. Non-automated	^{1/}	10.34
2. Automated	^{1/}	<u>4.06</u>
3. Cost Savings for Presorted Automation BMM	Line 1 - Line 2	6.28
<u>Cost Savings For Presortation</u>		
4. Single Piece BMM	^{1/}	10.47
5. Presorted Non-Automation BMM	^{1/}	<u>10.34</u>
6. Cost Difference Related to Presortation	Line 4 - Line 5	0.13
<u>Cost Savings For Single Piece Automation</u>		
7. Cost Savings for Automation	Line 3 - Line 6	6.15
^{1/} LR-I-81, sheet "TY letters (4)", page 4 of 4.		

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As shown in Table 1 above, the cost savings related to automation-compatible BMM equals 6.28 cents (Table 1, Line 3). The cost differential related to the presortation element of BMM equal 0.13 cents per piece (Table 1, Line 6). The net cost savings for an automation-compatible First Class single piece equal 6.15 cents per piece (Table 1, Line 7).

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B. COST SAVINGS FOR LETTERS FROM WITNESS MILLER

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As an alternative, I have reviewed the differences in mail processing and delivery costs for First Class letters as developed by Witness Miller. In Table 1 of Witness Miller's testimony he

1 identifies the worksharing related cost differentials between non-automation metered letters and
 2 automation BMM letters. Witness Miller’s worksharing-related cost savings reflect “operations
 3 that are directly affected by the presorting and/or prebarcoding activities performed by mailers....”
 4 and “...other activities that are also affected by worksharing”^{2/}. However, like LR-I-81, Witness
 5 Miller’s analysis must be adjusted to eliminate the cost savings related to single piece versus
 6 BMM. Table 2 below develops an alternative cost savings for automation-compatible letters using
 7 Witness Miller’s calculation of worksharing related costs:

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Table 2			
<u>Automation Cost Savings for Letters Based on Witness Miller</u>			
Item	Source	Cost Per Piece (cents)	
(1)	(2)	(3)	
1. Worksharing Related Costs Related to:			
a. Non-automation Presort Letters	Miller, App. I-1	13.718	
b. Automation Basic Presort Letters	Miller, App. I-1	<u>8.603</u>	
c. Cost Savings Due to Automation of Presort Letters	Line 1 - Line 2	5.115	
2. Cost Difference Related to Presortation	^{1/}	<u>0.091</u>	
3. Worksharing Related Cost Savings Related to Automation	Line 1c - Line 2	5.024	
^{1/} Miller, App. I-1, nonpresorted BMM of 13.809 cents less nonautomation presort BMM of 13.718 cents.			

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21 Based on Witness Miller’s analysis, adjusted to reflect the cost differences related to
 22 presortation, the worksharing-related cost savings equal 5.024 cents per piece (Table 2, Line 3).

^{2/} USPS-T-24, page 4.

1 C. COST SAVINGS FOR FLATS

2 The USPS' Witness Yacobucci develops the volume variable mail processing costs of First-
3 Class flat shaped mail. Witness Yacobucci's analysis in Table II-1 of his testimony summarizes
4 the "cost averages-normalized auto-related savings" which reflect the "weighted average mail
5 processing costs that isolate barcode-related savings."^{8/} He states that:

6 "This approach recognizes the expected barcode-related cost
7 savings from barcoded flats and the potential barcode-related cost
8 savings from nonbarcoded flats. The differences of the cost
9 averages, therefore, include cost-based signals of the costs avoided
10 by barcoded flats due to their barcodes and the costs that would be
11 avoided by nonbarcoded flats if they had barcodes."^{9/}

12 His analysis is summarized in Table 3 below:

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Table 3 Mail Processing Cost Savings for Automated Flats Developed by Witness Yacobucci		
<u>Item</u>	<u>Source</u>	<u>Cost Per Piece (cents)</u>
(1)	(2)	(3)
1. Basic Non-automation Flats	^{1/}	55.041
2. Basic Automation Flats	^{1/}	<u>49.940</u>
3. Cost Savings	Line 1 - Line 2	5.101

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23 ^{1/} USPS-T-25, Table II-1.

^{8/} USPS-T-25, page 2.

^{9/} USPS-T-25, page 28.

- 1 Based on Witness Yacobucci's analysis the mail processing cost savings for automation
- 2 (barcoding) of a flat is 5.101 cents per piece.

V. PASSTHROUGH PERCENTAGE FOR PROPOSED DISCOUNT

The accompanying testimony of E-Stamp’s Witness Michael Jones (E-Stamp-T-1) proposes a discount for IBI First Class letters of four (4) cents per piece. This discount is only applicable to letter size mail with the address and postage printed directly on the envelope. Based on the cost savings developed in Table 1 and Table 2 above, I have calculated the passthrough percentage for a 4 cent per piece discount.

Table 4
**Summary of Passthrough Percentage
 for Proposed IBI Discount-Letters**

<u>Item</u>	<u>Amount Per Piece (cents)</u>		<u>Passthrough Percentage^{3/}</u>
	<u>Cost Savings^{1/}</u>	<u>Proposed Discount^{2/}</u>	
(1)	(2)	(3)	(4)
1. Based on LR-I-81	6.2	4.0	65%
2. Based on Witness Miller	5.0	4.0	80%

^{1/} Line 1 = Table 1, Line 7; Line 2 = Table 2, Line 5.
^{2/} E-Stamp Witness Jones.
^{3/} Column (3) divided by Column (2).

Based on the cost savings for IBI letter mail, a discount of 4 cents per piece would reflect a passthrough percentage ranging from 65 percent to 80 percent.

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.

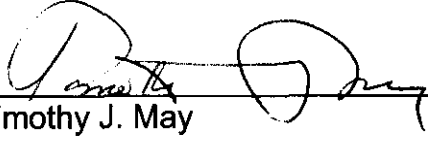
Over the course of the past twenty-two (22) years, I have participated in the development of cost of service analyses for the movement of coal over the major eastern, southern and western coal-hauling railroads. I have conducted on-site studies of switching, detention and line-haul activities relating 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.

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.



Timothy J. May

Dated: May 22, 2000