

BEFORE THE
POSTAL RATE COMMISSION
WASHINGTON DC 20268-00001

POSTAL RATE AND FEE CHANGES, 2006

REVISED
Docket No. R2006-1

DIRECT TESTIMONY
OF

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ON BEHALF OF
PITNEY BOWES INC.

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1 **Autobiographical Sketch**

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My name is Lawrence G. Buc. I am the President of SLS Consulting, Inc. ("SLS"), a Washington, D.C., consulting firm specializing in postal economics.

I have participated in rate and classification cases of the United States Postal Service ("Postal Service") for over 30 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 also been employed by the United States Postal Rate Commission ("Commission") and have been retained by private clients for consultations on postal topics.

This is the ninth case in which I have submitted testimony to the Commission. I have testified previously in four rate cases (R84-1, R90-1, R97-1, and R2000-1), three mail classification cases (MC76-1, MC77-2, and MC2004-3), and one complaint case (C99-4). I have testified on behalf of the Postal Service, intervenors, and the Office of the Consumer Advocate.

I attended Brown University and graduated in 1968 with an A.B. with honors in mathematics and economics. In 1978, I received an M.A. degree in economics from the George Washington University of America. While there, I was a member of Omicron Delta Epsilon, the national honorary economics society. I am a member of the American Economic Association.

1 **I. PURPOSE AND SCOPE**

2
3 In this testimony I propose a discount for Single-Piece First-Class Letter Mail
4 first-ounce postage evidencing purchased through retail sales channels that avoid the
5 transaction costs incurred by stamps sold directly by Postal Service employees at
6 USPS owned or leased facilities (i.e., stamps sold across USPS retail windows or
7 counters). The sale of stamps through traditional Postal Service retail windows is
8 expensive. Deaveraging the cost of postage evidencing for all retail sales channels
9 would promote economic efficiency and would assist the Postal Service in realizing its
10 ambitious goal of moving expensive transactions away from the Postal Service retail
11 window.

12 The expanded retail access discount that I propose is a broad conception of
13 “worksharing” in which the Postal Service uses pricing to incent any private sector
14 activity, including the activities of individual mailers, that reduces the costs of the Postal
15 Service. Although the logical extension of the arguments I present would be to
16 establish workshare discounts for all postage evidencing other than sales of stamps
17 across Postal Service windows, due to the lack of data produced by the Postal Service
18 the rate design proposed is limited to postage evidencing via permits, postage meters,
19 and PCPostage.

20 For these reasons and the reasons stated below, the Commission should
21 recommend an expanded retail access discount for postage evidencing methods that
22 avoid the transaction costs of selling stamps across a Postal Service retail window. The
23 Commission should further direct the Postal Service to undertake the studies necessary

1 to identify costs of all alternative retail channels so that these discounts could be made
2 available universally for single piece mailers.

3 In the remainder of this testimony, I describe the key elements of the proposed
4 expanded retail access discount, and explain why modifying the current rate structure
5 for Single-Piece First-Class Letter Mail to include some rate recognition of postage
6 evidencing would promote economic efficiency. Finally, I recommend a specific set of
7 expanded retail access rates.

8 **II. DISCUSSION**

9 **A. Deaveraging Single-Piece First-Class Mail Rates to Reflect Postage** 10 **Evidencing Costs Would Promote Economic Efficiency.**

11
12 Selling postage “across the window” is expensive. In Base Year (“BY”) 2005,
13 the total attributable cost for clerks to sell stamps for Single-Piece First-Class Mail at
14 Postal Service windows was \$22,1 236,000 (under the USPS method).¹ In BY 2005,
15 there were 19.76 billion of these stamps sold at the window. This yields a unit
16 attributable cost for a Single-Piece First-Class Mail stamp of 1.1 cents per piece.² See
17 Tr.18D/6524 (PB/USPS-T32-4 (redirected to USPS)). The piggybacked unit cost in the
18 base year was 1.6 cents or about 6 percent of the total attributable unit cost for Single-
19 Piece First-Class Mail. See USPS-LR-L-52, BYPBack.xls, tab USPSSummary for
20 piggyback factor of 1.41; see USPS-T-9, Exhibit USPS-9C, Cost and Revenue Analysis,
21 BY 2005, p.1, for unit attributable cost of 26.4 cents. Although the Postal Service has
22 not projected the cost for the Test Year, see Tr. 18D/6525 (PB/USPS-T32-5 (redirected

¹ The Postal Service and the Commission use different methods to estimate volume variability and costs in Cost Segment 3 (Clerks and Mailhandlers). These different methods lead to differences in calculated costs in this segment. References to the “USPS method” means that the costs are calculated under the method the Postal Service uses.

² There are also attributable costs for printing and other logistics costs for stamps which are not included in this figure.

1 to USPS)), given the three year period between the Base Year and the Test Year, the
2 unit attributable cost will likely approach 2 cents.

3 Productive efficiency would be improved by providing discounts to move stamp
4 sale transactions away from the windows to less expensive retail sales channels and
5 postage evidencing methods. As described in the comments of the Association for Mail
6 Electronic Enhancement, Financial Services Roundtable, National Association of
7 Presort Mailers, National Postal Policy Council, and Pitney Bowes, Inc. in response to
8 Notice of Inquiry No. 3, efficiency requires that cost differences be reflected in rate
9 differences. When rate differentials do not reflect cost differences, pricing does not
10 provide correct signals for efficient behavior.

11 The current rate structure for Single-Piece First-Class Mail fails to recognize any
12 of the unit cost differences caused by retail sales channel or postage evidencing
13 method used by the mailer. Yet the sales channel or postage evidencing method used
14 by the mailer is a cost causative characteristic of Single-Piece First-Class Mail. With no
15 discount reflecting cost avoided by sales channel or indicia, rates for Single-Piece First-
16 Class Mail depart from costs and send incorrect pricing signals.

17 **B. Deaveraging Single-Piece First-Class Mail Rates to Reflect Postage**
18 **Evidencing Costs Would Reduce the Postal Service’s Costs and**
19 **Improve Customer Service for Mailers.**
20

21 Since 2001, the Postal Service has undertaken an ambitious transformation
22 strategy to reduce costs and improve customer service. A central goal of the Postal
23 Service’s Transformation Plan is to “Move Simple Transactions away from the Retail
24 Counter.” See Transformation Plan Progress Report of November 2004,
25 Section 2.1.1. In furtherance of this goal, the Postal Service provides alternative retail

1 channels for First-Class Mail stamp sales through vending machines, Automated
 2 Postage Centers, from rural carriers, through Stamps by Mail, Stamps Online, Stamps
 3 by phone, and at Contract Post Offices and other consignment locations. See Tr.
 4 18D/6523, 6529 (PB/USPS-T32-3, 9 (redirected to USPS)). Notwithstanding the
 5 availability of these alternative retail channels, the vast majority of customers who use
 6 stamps for Single-Piece First-Class Mail still buy them at Postal Service retail windows.
 7 In the Base Year, approximately 84 percent of all Single-Piece First-Class Letter Mail
 8 stamp transactions occurred at the Postal Service retail window, as shown in Table 1,
 9 below.

10 **Table 1. Single-Piece First-Class Mail Stamp Sales by Channel**

Single-Piece First-Class Mail Sales Channel	BY Stamp Sales (000)	Percent Distribution (%)
Windows	19,757,069	84.0
Vending Machines	1,297,000	5.5
Stamps On Line	8,699	-
Stamps On Consignment	2,236,716	9.5
ATMs	180,738	.8
APC	40,563	.2
CPU	No Data	
Total Stamp Sales	23,520,785	100.0
Source: Institutional Responses of United States Postal Service Redirected from Witness Taufique to PB/USPS-T32-6,-12, -18, -27, -31, and -35.		

12 Accordingly, the Postal Service has yet to achieve a major objective of the 2002
 13 *Transformation Plan* — to increase customer convenience “without relying exclusively
 14 on traditional, and costly, “brick and mortar” solutions.” See *USPS Strategic*
 15 *Transformation Plan 2006-2010* (Sept. 2005) at 17. In other words, merely making
 16 alternatives available and promoting them may not be enough to move customers out of
 17 the lines of traditional Postal Service retail channels. See Tr. 18D/6530-35 (PB/USPS-

1 T32-10 (redirected to USPS)). The Postal Service has acknowledged, however, that it
2 has not attempted to incent more cost efficient consumer behavior by providing a
3 financial incentive to move simple transactions (e.g., stamp sales) away from “traditional
4 and costly” retail channels. See Tr. 18D/6536 (PB/USPS-T32-11(c) (redirected to
5 USPS)). Economic theory and empirical data produced by the Postal Service confirm
6 that without proper price signals or economic incentives, lines will likely continue to be
7 longer than necessary and the Postal Service will continue to incur costs that could be
8 avoided by encouraging consumers to use less expensive alternative retail channels
9 and postage evidencing methods.

10 **III. PROPOSED RATE DESIGN**

11 If adopted, the expanded retail access discounts proposed would be the first
12 “universal” workshare discounts to be available to Single-Piece First-Class Mail users
13 with small mail volumes. Unlike other worksharing discounts that require substantial
14 volumes of mail (e.g., 500 pieces, 20 pounds, etc.), these discounts would be available
15 to mailers of small volumes of mail so long as the postage evidencing did not take the
16 form of stamps purchased at USPS windows. Small mailers as well as large ones could
17 be incented to buy stamps over the Internet, through the mail, and from all the other
18 channels that are less expensive than the Postal Service window. Total Postal Service
19 costs would decline (perhaps by tens of millions of dollars) and prices would be reduced
20 for those purchasing through alternative channels. The adoption of an expanded retail
21 access discount would appropriately democratize worksharing discounts.

22 Ideally, the expanded retail access discounts would be made available to all
23 Single-Piece First-Class Mail types of postage evidencing that are not sold across

1 Postal Service retail windows. Thus, they would apply to PCPostage, metered mail,
2 and permit mail as well as to stamped mail. The discounts in the various channels
3 should be set at costs avoided, thus comporting with efficient component pricing
4 (“ECP”) and promoting economic efficiency in the system. Attributable costs of stocking
5 and repairing vending machines or kiosks, of any discounts provided to retail outlets, or
6 any other costs of selling postage in alternative retail channels should be considered,
7 and the discounts should reflect the difference between the marginal costs of selling
8 postage at windows and the marginal costs of selling postage in the alternative
9 channels. If cost avoidances are similar for different channels, they could be grouped
10 into tiers. For example, an expanded retail access discount could be structured to
11 provide one discount level for the least expensive alternatives and another for retail
12 alternatives with different cost characteristics that were still less than the costs of selling
13 a stamp across a Postal Service retail window.

14 I requested data from the Postal Service necessary to estimate the costs of sales
15 of stamps and postage evidencing for First-Class Single-Piece Letter mail in various
16 retail channels so that I could design efficient rates based on cost avoidance.

17 According to the Postal Service, it does not collect cost data on the 4 billion stamps that
18 it sells through alternative retail channels. See Tr. 18D/6525 (PB/USPS-T32-5
19 (redirected to USPS)). Given the lack of data, I designed a set of discounts based on
20 the information that is available.

21 Based on the available data, I know that it costs 1.6 cents in the Base Year to
22 sell a stamp across the window. These costs can be expected to increase in the Test
23 Year. I know that there are also costs involved in printing stamps. Based on the

1 available data, I know that in FY 2005, Single-Piece First-Class Mail comprised 43.4
2 billion pieces, 24 billion of which were stamped, 16.8 billion of which were metered, 2.1
3 billion of which were permit, and .5 billion of which were PVI.³ I also know that any clerk
4 and mailhandler attributable unit costs for postage evidencing for a metered piece⁴ or
5 for a permit piece, are de minimis. Given the time required to sell a stamp at the
6 window and the associated piggybacks, it is likely that it costs less to sell stamps in
7 vending machines, On-Line, in ATM's, and in APC's than at windows. Finally, I know
8 that economic efficiency requires that rates be deaveraged to reflect cost differences.

9 Notwithstanding the paucity of the Postal Service's data, it is important to not let
10 the perfect be the enemy of the good. Accordingly, the Commission should start the
11 deaveraging process by recommending very small discounts for those channels where
12 sufficient data is available — PCPostage, permit mail, and metered mail. I propose an
13 initial discount of 0.1 cent per piece. Starting with a modest initial discount has two
14 advantages. First, a 0.1 cent per piece discount for these retail channels is less than
15 cost avoided. Second, a modest initial discount will minimize the amount of potential
16 revenue leakage. Assuming a 0.1 cent per piece discount for permit, metered, and
17 PCPostage, if Test Year volumes by indicia are about the same as Base Year, the
18 revenue leakage would be less than \$19 million.

19 At the same time I suggest that the Commission direct the Postal Service to
20 study the cost of stamp sales and the cost of other forms of postage evidencing and

³ *Derived* by adding quarterly figures from Quarterly Statistics Reports, FY 2005, Tables 3-B, RPW Volume for Quarter, by Indicia at <http://www.usps.com/financials/qsr/welcome.htm>.

⁴ Postage meters are no longer set at windows, rather they are now set by phone and over the Internet. And, as USPS witness Davis testified, "Remote settings of postage meters involve an electronic transaction between the licensed customer and the meter manufacturer. The Postal Service has no operational role in such transactions and therefore incurs no cost for such settings." See Dkt. No. R2000-1, USPS-T-30, at 16.

1 present the results of these studies. Over time, and with better information, expanded
2 retail access discounts can be expanded to better reflect avoided costs for all alternative
3 retail sales channels and postage evidencing methods. Finally, I note that as rates are
4 deaveraged, consumers will be able to ameliorate any increased cost of window
5 purchases by switching to more convenient, lower cost payment evidencing methods.

6 **IV. CONCLUSION**

7 As I have demonstrated, the Postal Service's failure to recognize unit cost
8 differences for Single-Piece First-Class Mail caused by different retail sales channels or
9 postage evidencing is inconsistent with principles of economic efficiency and misses an
10 opportunity to lower the total combined costs for Single-Piece First-Class Mail. Failing
11 to deaverage these rates to account for these cost differentials also misses an
12 opportunity to democratize workshare discounts by making them available to small
13 single-piece mailers. For all of these reasons, the Commission should recommend the
14 expanded retail access discounts proposed for Single-Piece First-Class Mail with
15 postage evidenced via permits, metered mail, and PCPostage. The Commission should
16 also direct the Postal Service to develop the cost data necessary to deaverage all
17 expanded retail sales channels and postage evidencing methods, as appropriate.

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