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POSTAL RATE AND FEE CHANGES, 1997

Docket No. R97-1

REBUTTAL TESTIMONY
OF
HARRY J. BUCKEL
ON BEHALF OF THE
SATURATION MAIL COALITION

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March 9, 1998

REBUTTAL TESTIMONY OF HARRY J. BUCKEL

INTRODUCTION AND SUMMARY

1 My name is Harry J. Buckel. I am Chief Executive Officer of Newport Media,
2 Inc., the publisher of several shopper publications in Long Island, New York. My
3 autobiographical sketch is set forth in my direct testimony in this proceeding (SMC-
4 T-1), on behalf of the Saturation Mail Coalition. My rebuttal testimony addresses
5 several contentions by Association of Alternate Postal Systems (AAPS) witnesses
6 Bradstreet and Green in their direct testimony:

7 • First, their simplistic arguments (based on rate comparisons using a 1978
8 benchmark) that the pricing of saturation mail is unfair to competitors:

9 • Their arguments overlook what has happened to saturation mail in the
10 marketplace relative to competitors over the last 25 years.

11 • Their “apples and oranges” comparison of the excessive,
12 undiscounted, non-cost-based 1978 rates (which nearly drove
13 saturation mail out of the market) with the relatively more cost-based
14 current and proposed rates demonstrates the need for a lower pound
15 rate that is more in line with costs and the marketplace.

16 • Their claims of vulnerability to “unfair” competition ignore the fact that
17 saturation mail constitutes a smaller portion of total mail volume and
18 competes for a narrower segment of the market than in 1986.

19 • Second, witness Bradstreet’s claims about the effect of weight on delivery
20 costs, which ignore the predictability and deferability of saturation mail.
21 These characteristics, I can personally attest to, enhance the ability of
22 carriers to manage their workload and enable them to use saturation mail as
23 a load leveler to accommodate delivery of other mail on high volume days.

1 • Third, witness Green's statements about the current and proposed rates for
2 ECR mail. Contrary to his written testimony that saturation mail rates are
3 unfairly priced, Green acknowledged that:

- 4 • weight is a relatively insignificant factor in private delivery costs or
5 rates;
- 6 • at the current ECR saturation rate, "the costs of direct, solo mail" are
7 "prohibitive" for advertisers; and
- 8 • at the current ECR pound rate, the cost of mailing his publication,
9 either as solo or shared mail, would likewise be "prohibitive."

10 A. The Historical Reality Of The Competitive Marketplace.

11 Bradstreet and Green try to paint a picture that saturation mail over the
12 years has been priced "unfairly" low, using 1978 as their benchmark. Noticeably,
13 they present no evidence of harm to their businesses; they just say that "low"
14 saturation rates are unfair. What is missing are the facts about what has happened
15 in the marketplace over the years relative to postal rates.

16 The history of the saturation mail market since 1970 has been described in
17 prior proceedings by Advo witnesses Jack Valentine (Docket R84-1), Vince Giuliano
18 (Dockets R87-1 and C89-3), and Kam Kamerschen (Docket MC95-1). In the early
19 1970s, saturation solo mail was a strong competitor for distribution of preprints -- at
20 undiscounted solo mail rates. Many of the preprints carried in the mail were
21 traditional heavier preprints weighing up to two ounces or more. By 1978, however,
22 third class postal rates doubled, causing saturation mail volumes to plummet.
23 Saturation mail's share of the growing preprint market declined precipitously, from
24 an estimated 30% share down to 10% (see Giuliano, R87-1 Tr. 16068-69). Former
25 USPS saturation mail customers switched to private delivery and became
26 competitors.

1 Not surprisingly, Bradstreet begins his historical discussion of postal rates in
2 1978. This was the low point for saturation mail as a competitive medium, due to
3 excessively high postal rates that failed to reflect the low costs and price sensitivity
4 of saturation mail. The third class rate structure contained no worksharing
5 discounts. Low-cost saturation mail that was carrier route presorted, walk
6 sequenced, and entered close to the destination paid the same rate as high-cost,
7 basic-level third class mail that was presorted minimally to mixed-states,
8 unsequenced, and entered at an origin post office for distribution to far away delivery
9 offices around the country. Within third class, saturation mail was severely over-
10 priced in relation to its low costs.

11 The beneficiaries of that irrational, non-cost-based rate structure were
12 newspapers, and private delivery competitors. As much as they might like to return
13 to the "good old days" of the late 1970s, it is absurd for them to now tout those
14 exorbitant, non-competitive, non-cost-based saturation mail rates as the
15 "benchmark" for gauging either rates or the marketplace.

16 Solo saturation mail never really recovered from those high rates. It exists
17 today on the periphery of the preprint market -- a fact acknowledged by witness
18 Green (AAPS-T-2 at 3). It wasn't until the early 1980s, following introduction of the
19 carrier route presort discount in 1979 and the shared mail concept in 1980, that
20 saturation mail again became competitive and began to recapture a share of the
21 preprint market. During most of the 1980s, heavier 1-2 ounce preprints were
22 common in shared mail and mailed shoppers.

23 Then in 1988, the R87-1 rate increase sent a tsunami through the saturation
24 mail industry. The carrier route piece rate increased 22 percent (from 8.3¢ to
25 10.1¢), and the pound rate increased 26 percent (from 38¢ to 48¢). Saturation
26 volumes declined, newspapers shifted their TMCs from mail to private delivery, and
27 the private delivery industry grew rapidly (see Kamerschen, MC95-1 Tr. 10158-62,

1 10172-75). The combination of the large rate increase and the high pound rate also
2 caused a downward shift in the mix of saturation mail preprint inserts. Preprint
3 inserts over one ounce began to leave saturation mail. Saturation mail was left with
4 predominantly light-weight preprints under one ounce: single page slipsheet
5 inserts, and 4-8 page inserts. Heavier preprints are now carried almost exclusively
6 by newspapers and private delivery.

7 In the 1990s, walk sequence discounts, drop ship discounts, and
8 reclassification have helped to mitigate rate increases, finally enabling saturation
9 mail to rebound from the R87-1 rate increase. Even today, however, saturation mail
10 constitutes a smaller proportion of both third class/Standard A and total mail volume
11 than in 1986, prior to the R87 rate increase.¹

12 Over the last 25 years, the saturation mail industry has gone from being a
13 major competitor for distributing traditional heavier-weight preprints at solo mail
14 rates, to an industry mostly confined to distributing lighter-weight preprints as
15 inserts in a shared mail or shopper publication. The proposed pound rate will not
16 make saturation mail once again competitive for those heavier weight preprints. But
17 it will at least mitigate the competitive disparity, allowing us to remain competitive for
18 our current volumes and to compete at the margin for lighter weight preprints up to
19 one ounce.

¹ From FY 1986 to FY 1996, total domestic mail volume grew 26% while carrier route mail volume (which includes saturation mail) grew only 21%. Carrier route volume declined as a percentage of both total BRR mail and total domestic mail. Although the USPS did not separately collect saturation volume data in 1986, other information confirms that this decline in carrier route mail's share of total volume was due to lagging saturation mail volumes. In 1986, for example, Advo's volumes were 16.6% of total carrier route volumes, 9.1% of BRR volumes, and 2.8% of total domestic mail volumes. In 1989, Advo's volumes declined to 13.3% of carrier route, 7.5% of BRR, and 2.4% of total domestic mail volumes (C89-3 Tr. 61 compared to FY86 and FY89 USPS volumes). Another indication of saturation mail's declining proportion of total volumes comes from a 1989 USPS special study showing that saturation mail then constituted 44% of carrier route and 23% of total BRR volumes (USPS LR-F-199, Appendix 10, Docket R90-1). By 1996, saturation mail was only 35% of carrier route and 17% of total BRR volumes (USPS LR H-145, Section G2, Docket R97-1).

1 It is a myth that private delivery and newspaper preprint distribution is
2 "vulnerable" to saturation mail competition. The vulnerability is in the other direction.
3 Our rates, and our competitive position in the market, are dictated by the rates
4 established through this postal rate regulatory process. The prices charged by
5 newspapers and private delivery are not. They can adjust their rates based on their
6 costs and the marketplace, while at the same time urging that saturation postal
7 rates be kept high, without regard to costs or the marketplace, in order to fund lower
8 rates for other mail classes.

9 Saturation mail has remained competitive in the preprint market only by
10 evolving from solo mail distribution (the cost of which AAPS witness Green
11 concedes is now "prohibitive", AAPS-T-2 at 3), to shared mail or shopper
12 distribution. Even there, the segment of the market for which saturation mail is price
13 competitive has been narrowed over time due to the artificially high pound rate.
14 Despite what the Commission may hear about statements in "marketing plans," the
15 newspaper and private delivery competitors of saturation mail are strong and
16 growing. They will be an increasing threat to this important segment of mail volume
17 unless postal rates for saturation mail are brought more in line with costs and the
18 marketplace.

19 B. Rebuttal To Bradstreet's Effect Of Weight On Costs

20 Bradstreet argues that weight has a significant effect on delivery carrier
21 costs by causing extra trips to and from the carrier's delivery vehicle. I am not a
22 postal costing or operations expert, but I know that carriers have flexibility to deal
23 with unexpected volumes, particularly with respect to saturation mail, because I
24 know what carriers do with our mail.

25 To begin with, saturation mail is one of the most predictable portions of the
26 carrier's workload. Our program is mailed on a regular weekly basis, arriving at the
27 delivery office on a consistent schedule each week. This is typical of the saturation

1 mail industry. For a given carrier route, even the weights of our mailings are
2 consistent and predictable from week to week.

3 Moreover, our mailings can be, and in fact are, deferred if carriers have a
4 particularly large volume of mail on a particular day. The most common occurrence
5 of this is on days following Monday holidays, when carriers are confronted with an
6 extra day's buildup of mail. Our mail will be deferred for Wednesday delivery so the
7 carrier can deliver the holiday overflow mail on Tuesday. This also occurs on a
8 sporadic basis whenever a carrier has an unusually large volume of other mail to
9 deliver. A carrier can also defer a portion of our mail for the route on a given day,
10 which may occur if particular relays on the route have abnormal mail volumes. I
11 would point out that these deferrals are typically due not to the total weight of the
12 mail that must be carried, but rather the extra in-office time required to sort and
13 prepare the larger-than-normal volume of mail pieces. In any event, this load
14 leveling capability of saturation mail enhances the carrier's ability to deal with
15 volume fluctuations, whether due to increased pieces or weight.

16 C. Rebuttal To AAPS On The Pound Rate

17 Neither Bradstreet nor Green provided information about their
18 historical volumes or how their volumes or rates compare to those available
19 through saturation mail. What is clear, however, is that weight is not nearly as
20 significant a factor in the rates they charge as it is for saturation mailers, and that
21 the current high postal pound rate gives them a powerful competitive advantage.
22 This was confirmed by Green during cross-examination. When asked what the
23 typical weight was for his publication, including inserts, he responded:

24 "That's a difficult question, because we haven't been concerned
25 with weight for so long since we're in the hand delivery." Tr.
26 11973.

27 His acknowledgment about the relative insignificance of weight as a pricing factor
28 for private delivery is entirely consistent with my own knowledge of the cost and rate

1 characteristics of private delivery and newspaper preprint distribution, as described
2 in my initial testimony.

3 When asked by Commissioner LeBlanc why he can't or chooses not to use
4 either solo or shared mail, Green explained:

5 "The other problem is the shared mail is in the post office and it is
6 mailed. And so, as a result, when I drop in 40 pages of tabloid
7 newsprint, along with six inserts, it drives that cost up substantially
8 to where I don't really fit in their package. I would have to pay, you
9 know, the incremental cost of putting my piece into their package
10 would make it prohibitive." Tr. 11970.

11 The "prohibitive incremental cost" that Green refers to, of course, is the current high
12 pound rate for saturation mail. In fact, for the bulk of Green's programs (those
13 weighing over the breakpoint), that prohibitive incremental mailing cost would be the
14 same whether he used solo or shared mail.²

15 The prohibitive pound rate applies not only to Green's publication but to
16 heavier inserts carried in his publication. His example of a 24-page tabloid insert,
17 which would weigh about 2.4 ounces, would be prohibitive to mail even at the
18 proposed pound rate, as I explained in my direct testimony.

19 Brushing aside AAPS's rhetoric, Green's candid statements about the non-
20 competitive nature of the current high pound rate and the realities of the market-
21 place corroborate my direct testimony, and are compelling evidence of the need for
22 the Postal Service's proposed ECR rates.

23 D. Rebuttal to NAA witness Chown

24 Chown proposes a dramatic change in the way rates are set, based
25 on a reweighting of attributable costs. To me as a businessman, the mechanics of

² Green estimated that his publication alone weighs between "two to five or six ounces," plus additional weight for inserts that range from single pages to 24-page tabloid inserts (a 24-page tabloid insert typically weighs over two ounces). With inserts, his program ranges from 2-3 ounces up to 7-8 ounces -- the bulk of which weighs more than the 3.3 ounce breakpoint and would have to pay the pound rate if mailed. Tr. 11974.

1 her proposal are not important. What is clear is its goal: to provide an excuse to
2 raise the rates of price sensitive ECR mail like ours that competes with
3 newspapers. It seems to me that NAA started with this goal in mind and then
4 Chown contrived a methodology to get there that totally ignores marketplace
5 realities.

6 Chown's approach is based on the premise that ECR mail is not paying its
7 fair share of institutional costs. Her premise is incredible. The USPS proposed
8 228% cost coverage for ECR mail -- high by any measure -- is in fact hardly different
9 from the high implicit cost coverages on carrier route mail even before reclassifica-
10 tion. NAA vigorously opposed reclassification, and apparently see this as a means
11 to undo the Commission's reclassification decision.

12 As a businessman in a highly competitive business, it does not matter what
13 kind of formula or benchmark the Commission uses to arrive at the rate I must pay.
14 The thing that matters is the rate. Whatever the formula, if the resulting rate is too
15 high, I will not be competitive. My only "choices" will be to leave the mail and expand
16 our alternate delivery, or to watch my customers leave and go out of business.

17 A striking aspect of Chown's proposal is its methodological number
18 shuffling, "weighting" this cost up (ECR's) and that cost down to come up with a
19 non-cost base for a pricing markup. What is lost in this shuffle is the ultimate
20 objective of setting prices that make sense, reflect real costs, and meet the needs
21 of the market. To do this, you have to take into account the varying price sensitivities
22 of the customers. That, however, is not NAA's objective.

23 Like the Postal Service, our business serves a variety of customers that have
24 differing cost and demand characteristics. If we were to try to price our services to
25 extract increased markups and margins from our most price sensitive customers
26 (preprint advertisers), for the benefit of our relatively less price sensitive customers
27 who have fewer competitive choices, we would fail. Rather than increasing our

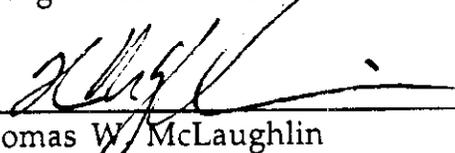
1 contribution from price sensitive advertisers, we would lose them to competitors,
2 along with the contribution they currently make. Our other advertisers, the
3 ostensible beneficiaries of this pricing scheme, would lose, too. If we could not
4 raise their rates sufficiently to recover the lost contributions, we would have to either
5 shift to private delivery or go out of business.

6 A marketplace approach to pricing is not synonymous with Ramsey pricing or
7 "charging what the market will bear." Even in our business, we have customer
8 segments with few alternatives where we could raise prices somewhat and achieve
9 greater short-term profits. We choose not to do so, not for charitable reasons, but
10 because affordable rates will encourage them to advertise, help their businesses
11 grow and prosper, and ultimately enable them to increase their advertising with us,
12 to our mutual long-term benefit. Without market-based prices and the contribution
13 from our most price sensitive customers, we could not afford to do this, and our
14 other customers would be worse off. Our pricing focus has to be on the market-
15 place, looking at the pricing mix that is best for us and our customers over the long
16 run.

17 This, in my view, is the only way that the Postal Service can succeed in
18 dealing with the market realities it faces. Artificial pricing schemes like NAA's would
19 do just the opposite, to the detriment of the Postal Service and all customers.

CERTIFICATE OF SERVICE

I hereby certify that I have on this date served the foregoing document upon all participants of record in this proceeding in accordance with section 12 of the Rules of Practice.



Thomas W. McLaughlin

March 9, 1998