

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

POSTAL RATE AND FEE CHANGES, 2006

Docket No. R2006-1

**DIRECT TESTIMONY
OF
ROGER C. PRESCOTT**

On Behalf Of
MAIL ORDER ASSOCIATION OF AMERICA

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DIRECT TESTIMONY

OF

ROGER C. PRESCOTT

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3
4 My name is Roger C. Prescott. I am Executive Vice President of the economic
5 consulting firm of L. E. Peabody & Associates, Inc. The firm's offices are located at 1501 Duke
6 Street, Suite 200, Alexandria, Virginia 22314 and 5901 N. Cicero Avenue, Suite 504, Chicago,
7 Illinois 60646. I presented testimony before the Postal Rate Commission ("PRC") regarding
8 Third Class Bulk Regular ("TCBRR") and Standard (A) commercial mail rates in Docket No.
9 R90-1, Postal Rate and Fee Changes, 1990 ("R90-1"), Docket No. MC95-1, Mail Classification
10 Schedule, 1995 Classification Reform I ("MC95-1"), Docket No. R97-1, Postal Rate and Fee
11 Changes, 1997 ("R97-1") and Docket No. R2000-1, Postal Rate and Fee Changes, 2000
12 ("R2000-1"). I also presented testimony before the PRC regarding the proposed mail service
13 in Docket No. MC98-1, Mailing Online Service ("MC98-1"). I have on numerous prior
14 occasions presented evidence before the Surface Transportation Board (formerly the Interstate
15 Commerce Commission) on economic ratemaking and cost finding principles. My
16 qualifications and experience are described in Appendix A to this testimony.

1 **I. PURPOSE OF TESTIMONY**

2 In this current proceeding, the United States Postal Service’s (“USPS”) Witness Donald
3 J. O’Hara (USPS-T-31) presents the USPS’s proposed cost coverages for each subclass and
4 explains “why these proposals accord with the pricing criteria in the Postal Reorganization Act”.¹

5 Regarding Standard mail, Witness O’Hara concludes that the proposed coverage ratio for the
6 Enhanced Carrier Route (“ECR”) subclass of 214 percent is a “reasonable contribution per piece
7 for ECR”.² Witness O’Hara further notes “that at proposed rates, contribution per piece is about
8 the same in ECR and Standard Regular (both round to 10.0 cents) despite the different cost
9 coverages (214% and 177%).”³

10 I have been requested by the Mail Order Association of America (“MOAA”) to review
11 the direct testimony, underlying workpapers and interrogatory responses of USPS’s Witness
12 O’Hara to determine if the rates for ECR mail proposed by the USPS comport with the pricing
13 factors of the Postal Reorganization Act. My analysis also examines the historical changes in
14 volumes and coverage ratios for the ECR subclass. The results of my analyses are summarized
15 under the following topics:

16 II. Summary and Conclusions

17 III. Establishment of the ECR Subclass

¹USPS-T-31, page 1.

²USPS-T-31, page 30.

³USPS-T-31, page 30. During his cross examination (Tr. 17/5252) and in his September 1, 2006 response to questions posed by ValPak, Witness O’Hara acknowledged that the correct coverage ratio for Standard Regular mail is 176 percent, not 177 percent.

- 1 IV. Elasticity of ECR Mail
- 2 V. Standard Mail Contribution Per Piece
- 3 VI. Historical Changes in Coverage Ratios
- 4 VII. Historical Changes in ECR Volumes

1 **II. SUMMARY AND CONCLUSIONS**

2 Based on my review and analysis of the USPS's proposed rates for Standard ECR Mail,

3 I conclude the following:

4 1. The PRC established the ECR subclass in the MC95-1 proceeding in order to
5 recognize the unique cost and demand differences for carrier route mail. The
6 USPS rates proposed in this proceeding do not present an overall approach to
7 market-based pricing in order to preserve (or increase) mail volumes and
8 demonstrate that the USPS has failed to price ECR appropriately. The rates
9 proposed by USPS in this proceeding are expected to generate a substantial
10 decline in ECR volumes.
11

12 2. Witness O'Hara's testimony only developed the contribution per piece for
13 comparison between Standard Regular and Standard ECR mail. The PRC has
14 recognized that proper rate-setting guidelines should not consider the contribution
15 to institutional costs on a per piece basis.

16 3. The USPS's analysis of the own-price elasticity has shown that the elasticity of
17 ECR mail has increased over time. This means that increased rates for ECR mail
18 are having a more substantial impact on volumes today than in past years.

19 4. The coverage ratio implicit in the Test Year After Rates ("TYAR") rates
20 recommended by the PRC for the three rate cases since the establishment of the
21 ECR subclass (R97-1, R2000-1, and R2001-1) all dramatically understated the
22 coverage ratios when the actual data became available. In those three
23 proceedings, the PRC envisioned that coverage ratios for ECR mail would range
24 between 195 percent and 201 percent. The actual coverage ratios for ECR mail
25 ranged between 233 percent and 263 percent.

26 5. If the historical relationship between the proposed and actual coverage ratios hold
27 going forward the USPS's proposed rates in this proceeding for the TYAR time
28 period (2008) will have a coverage ratio ranging between 256 percent and 280
29 percent.

30 6. Between 1998 and 2004, the volume of commercial mail in the ECR subclass
31 declined from 34.1 billion pieces to 30.3 billion pieces, a decline of 11 percent.
32 The commercial portion of the ECR subclass saw an upswing in volume in 2005
33 to 32.0 billion pieces, which was still 6 percent less than the 1998 volume. The
34 USPS's rate proposal is predicted to result in a TYAR (2008) volume of 29.3
35 billion pieces or a decline of 14 percent over 1998 levels and a decline of 8
36 percent over 2005 levels. The decline in the TYAR ECR volume is due, in part,

1 to the expected migration of mail to the Standard Regular subclass because of the
2 elimination of the automation discount for ECR mail. However, even without this
3 migration, the ECR volume is estimated to equal 31.4 billion pieces, a decline of
4 8 percent from 1998 levels and 2 percent below 2005 levels.

1 **III. ESTABLISHMENT OF THE ECR SUBCLASS**

2 The PRC established the ECR subclass in the MC95-1 proceeding. In that proceeding,
3 the PRC stated that it “accorded subclass to a grouping of mail when that status will facilitate
4 the application of the ratemaking factors of the Act”.⁴ The PRC went on to recognize that cost
5 and demand differences are important for defining a subclass.⁵ The PRC, in MC95-1, was
6 “satisfied that the proposed Enhanced Carrier Route subclass has distinct demand characteristics
7 which indicate differences in value to senders”⁶ and, therefore, the “significant cost differences,
8 coupled with substantial evidence of different demand between Enhanced Carrier Route and all
9 other Bulk Regular Rate mail, are sufficient to warrant recommendation of separate subclass
10 treatment”.⁷

11 The pricing of a subclass should recognize the unique cost and demand differences for
12 that subclass. In the current proceeding (R2006-1), Witness O’Hara contends that the USPS’s
13 rate proposals “accord with the pricing criteria in the Postal Reorganization Act”.⁸ As part of
14 his testimony, he listed the following nine pricing criteria considered in setting postal rates:

⁴Docket No. MC95-1, Opinion and Recommended Decision, January 26, 1996 (“MC95-1 Decision”). page I-2, footnote omitted.

⁵MC95-1 Decision, page I-3. The USPS’s Witness McBride in the MC95-1 proceeding stated that his goal was “to reflect cost and market factors that are different within the current subclasses and make those more similar by creating new subclasses” that are more homogeneous (MC95-1 Decision, page II-35).

⁶MC95-1 Decision, page III-46.

⁷MC95-1 Decision, page V-160.

⁸USPS-T-31, page 1.

- 1 1. The establishment and maintenance of a fair and equitable schedule;
- 2 2. The value of the mail service actually provided each class or type of
3 mail service to both the sender and the recipient including, but not limited to
4 the collection, mode of transportation, and priority of delivery;
- 5 3. The requirement that each class of mail bear the direct and indirect
6 postal costs attributed to that class plus that portion of all other costs of the
7 Postal Service reasonably assignable to such class or type;
- 8 4. The effect of rate increases upon the general public, business mail
9 users, and enterprises in the private sector of the economy engaged in the
10 delivery of mail matter other than letters;
- 11 5. The available alternative means of sending and receiving letter and
12 other mail matter at reasonable costs;
- 13 6. The degree of preparation of mail for delivery into the postal system
14 and its effect upon reducing costs to the Postal Service;
- 15 7. Simplicity of structure for the entire schedule and simple, identifiable
16 relationships between the rates or fees charged the various classes of mail for
17 the postal services;
- 18 8. The educational, cultural, scientific and informational value to the
19 recipient of mail matter; and
- 20 9. Such other factors as the Commission may deem appropriate.⁹

21 The establishment of the ECR subclass was intended to allow the USPS the ability to
22 develop an overall approach to market-based pricing, consistent with the criteria of the Postal
23 Reorganization Act, which would help preserve or increase mail volumes for the Third Class
24 Bulk Rate Regular carrier route mail that became the ECR subclass.

⁹USPS-T-31, page 8.

1 The pricing of ECR mail since the establishment of the subclass reflects the failure to
2 price this product appropriately. In MC95-1, the PRC recognized that ECR needed to have rates
3 which would encourage volume growth, stating:

4 The threat of competition drives virtually all the Postal Service’s proposals in this
5 case. For example the proposed Enhanced Carrier Route subclass is described as
6 a ‘first step to counter...competitive strategy...and prevent cream skimming.’
7 USPS-T-1 at 29-30. Low-cost mailstreams are encouraged not only to boost
8 Postal Service efficiency, but also to ‘reduce Postal Service unit costs on average,
9 which in turn should lead to more competitive rates, which should lead to
10 increasing volumes.’ Id. at 33.¹⁰

11 The importance of establishing prices that will maintain or increase volumes has also
12 been discussed by Postmaster General John E. Potter. In his January 28, 2004 statement before
13 the Special Panel on Postal Reform and Oversight Committee on Government Reform, United
14 States House of Representatives, Postmaster General Potter stated the following:

- 15 1. “The robust growth of private-sector delivery services – from packages
16 to time-sensitive communications – has also altered the competitive
17 landscape. (Page 3);
- 18
19 2. Flexibility “would ensure that the Postal Service’s governing body and
20 management have the authority to reduce costs, set rates, and adjust key
21 aspects of its business in order to meet its obligations to customers in a
22 dynamic marketplace”. (Page 4);
- 23
24 3. The Postmaster General agreed with the Commission that the USPS
25 “must have the flexibility to alter its retail and processing networks to
26 meet changing customer needs”... and “processes for pricing non-
competitive and competitive products and services.” (Page 5);
- 27
28 4. “We have seen a growing consensus, within the mailing community and
29 through previous postal legislative reform efforts, for a pricing structure
30 that will increase rate predictability for customers and provide
31 management with additional flexibility to respond to market needs,
while covering its costs.” (Page 5); and,

¹⁰MC95-1 Decision, pages II-37 to II-38.

1 5. "We need a Postal Service that has the ability to implement rates that are
2 responsive to the market and that will mitigate large rate increases that
3 have become counterproductive." (Page 12).

4
5 Based on the trend in increasing rates and stagnant or decreasing volumes for commercial
6 ECR mail, I conclude that the rates proposed by the USPS for ECR accord with neither the
7 purposes of establishing the subclass in the MC95-1 proceeding nor Postmaster General Potter's
8 recognition that rates should be "responsive to the market." As discussed in more detail below,
9 the increased rates for commercial ECR mail proposed by the USPS in this proceeding are
10 expected to cause a 14 percent decline over current (2005) volume levels. That is
11 counterproductive and certainly not "responsive to the market".

1 **IV. ELASTICITY OF ECR MAIL**

2 Changes in rates will impact the volume of ECR because of the elasticity of ECR mail.
3 Own-price elasticity measures the degree to which the demand (i.e., volume) for a product
4 changes with changes in prices.¹¹ The USPS’s Witness Peter Bernstein in R2001-1 recognized
5 that “less elastic products should have higher mark-ups because large mark-ups on more elastic
6 products is an ineffective way of raising net revenue, due to the large volume losses that result”...
7 and “a product that becomes more price elastic (due to technological competition or for any other
8 reason), should have lower mark-ups than if it were less price elastic.”¹²

9 Witness O’Hara also acknowledges that elasticity has an impact on volume. In his cross
10 examination in this proceeding, Witness O’Hara stated that “the least elastic product is therefore
11 not going to respond to higher prices, so you’re not going to distort the amount that’s
12 consumed...” (Tr. 17/5268). Witness Thress, in this proceeding, calculates that commercial
13 ECR mail “is among the highest own-price elasticities estimated in [his] testimony, reflecting
14 the competitiveness of the advertising market and the extent to which relatively close substitutes
15 exist for Standard ECR mail”.¹³ He also stated that “with respect to value of service (criterion
16 2), a high (in absolute value) elasticity argues for a relatively low cost coverage” (Tr. 17/5096).
17 Witness O’Hara’s proposed pricing for ECR mail does not follow these guidelines.

18 The own-price elasticity for commercial ECR mail has been increasing since the subclass
19 was established. Stated differently, the USPS’s calculation shows that ECR mail is more
20 sensitive to price increases now than in past proceedings. The own-price elasticity of rates for

¹¹See, for example, Tr. 17/5081.

¹²R2001-1, USPS-T-10, page 67.

¹³USPS-T-7, page 120.

1 ECR mail has changed from -0.598 in R97-1 to -1.080 in R2006-1.¹⁴ The increasing elasticity
2 means that rate increases in R2006-1 will create a greater decline in volume than caused by the
3 increased rates in R97-1. This increased sensitivity should caution the PRC to avoid any
4 increases in rates for ECR mail.

¹⁴R97-1, USPS-T-30, page 5 and R2006-1, USPS-T-31, page 11.

1 V. STANDARD MAIL CONTRIBUTION PER PIECE

2 Witness O'Hara's testimony notes that the USPS's proposed rates results in a contribution
3 per piece for Standard Regular and ECR mail where "both round to 10.0 cents."¹⁵ The
4 comparison of the contribution per piece between the two Standard mail subclasses is
5 inappropriate because Witness O'Hara admitted in a response to an interrogatory that "obtaining
6 similar unit contributions across subclasses is not a goal of the Postal Service in this case."¹⁶ The
7 stated purpose for Witness O'Hara's testimony is "to present the Postal Service's proposed cost
8 coverages (or 'rate-levels') for each subclass and special service and explain why these proposals
9 accord with the pricing criteria in the Postal Reorganization Act."¹⁷ The importance in
10 presenting the contribution per piece is never explained by Witness O'Hara. Witness O'Hara's
11 reliance on the contribution per piece is not valid in this proceeding for the comparison of
12 Standard Regular with ECR mail.

13 In his direct testimony, Witness O'Hara does not rely on the contribution per piece when
14 examining any class or subclass of mail other than his comparison of the contribution per piece
15 for Standard Regular and ECR mail. While he acknowledges that cost differences due to the
16 degree of mailer preparation should be reflected in the rates, he states that it is "important to
17 retain a reasonable contribution per piece for ECR."¹⁸ Witness O'Hara does not apply this per
18 piece metric to any other subclasses except for Standard Regular and ECR mail. Stated

¹⁵USPS-T-31, page 30.

¹⁶Tr. 17/5076.

¹⁷USPS-T-31, page 1.

¹⁸USPS-T-31, page 30.

1 differently, the only use of his “reasonable contribution per piece” metric is to justify his
2 equalizing the contribution per piece between ECR and Standard Regular mail. Witness
3 O’Hara’s proposal attempts to give the appearance of balance between the Standard Regular and
4 ECR subclasses, but only by raising the contribution for Standard Regular mail and unwisely
5 ignoring the elasticity of ECR mail. This equalization, which is not supported by the pricing
6 criteria of the Postal Reorganization Act, results in contribution levels that are unfair for both
7 subclasses; i.e., ECR contribution per piece is too high and then Standard Regular mail is
8 increased to the levels of ECR mail. This is not a proper basis for developing rates.

9
10 Historically, the PRC has not relied on contribution per piece to validate rates. In R94-1,
11 the PRC stated that no attention was given to the implicit contribution of any individual piece.¹⁹
12 In R2001-1, the PRC stated that the measure of the institutional burden for any subclass should
13 be determined based on the coverage ratios and mark-up indexes.²⁰ In the current proceeding,
14 the PRC should be guided by past precedents and not rely on the comparison of the contribution
15 per piece when determining the rates for ECR mail.

16 Witness O’Hara also stated that while the historical contribution per piece should not be
17 “carved in stone”, he did think “that pre-existing contribution levels provide a good starting-point
18 for developing a new set of contribution levels that respond to new conditions.”²¹ In addition,

¹⁹Postal Rate and Fee Changes, 1994, Docket R94-1, Opinion and Recommended Decision, November 30, 1994, page V-95.

²⁰Postal Rate and Fee Changes, 2001, Docket No. R2000-1, Opinion and Recommended Decision Approving Stipulation and Agreement, March 22, 2002, pages 39-40.

²¹Tr. 17/5112.

1 the USPS's rate structure in this proceeding fails to adhere to the pre-existing contribution levels
2 for ECR mail.

3 The contribution per piece for ECR mail, based on the TYAR shown by Witness O'Hara
4 equals 10.0 cents per piece. A contribution at this level does not follow the historical level of
5 contribution for ECR mail. In 2005, the contribution per piece for ECR mail equaled 8.4 cents
6 per piece²² which is 16 percent below the contribution per piece in the USPS's TYAR proposed
7 rates. Over the 1997 through 2005 time period, the average contribution per piece for ECR mail
8 equaled 8.6 cents per piece which is 14 percent below the USPS's TYAR proposed rates.²³
9 Therefore, if Witness O'Hara intends to utilize historical levels of the contribution per piece
10 as guidance for setting rates in the ECR subclass, the current proposed rates are too high.

²²In 2005, the coverage ratio for ECR mail was 204 percent. Tr. 17/5123.

²³Average contribution per piece for ECR mail from 1997 to 2005 as shown in Witness O'Hara's response to NAA/USPS-T31-9 (Tr 17/5125).

1 **VI. HISTORICAL CHANGES IN COVERAGE RATIOS**

2 In MC95-1, the PRC replaced the Third Class Bulk Rate Regular subclass with two new
3 subclasses, the Standard Regular subclass and the ECR subclass.²⁴ For these two new subclasses,
4 the PRC found that “clear indications of significant cost differences, coupled with substantial
5 evidence of different demand between Enhanced Carrier Route and all other Bulk Regular Rate
6 mail, are sufficient to warrant recommendation of separate subclass treatment”.

7 At pages 13 and 14 of his testimony, Witness O’Hara explains that worksharing that
8 removes costs will, with all other factors held constant, lead to higher coverage ratios. Thus,
9 according to Witness O’Hara, “to maintain its contribution, the coverage of a subclass with a
10 greater-than-average increase in worksharing will need to increase relative to the system-average
11 coverage.”²⁵ Witness O’Hara further supports the idea that coverage ratios should be high for
12 subclasses with large amounts of worksharing stating “increasing the cost coverage of a subclass
13 by a particular amount is the result of a decision to retain the previous distribution of the
14 institutional cost burden across subclasses, not a policy objective in itself” (Tr. 17/5074).

15 The application of the nine pricing criteria of the Postal Reorganization Act compel a
16 pricing structure different than proposed by the USPS. The PRC must look at the impact of the
17 USPS’s proposed pricing for ECR mail which does not appear to be in the best interest of either
18 the USPS or the mailers in the ECR subclass.

19 The PRC’s calculation of coverage ratios reflects the revenues of the subclass divided by
20 the attributable costs for the subclass. The rates set by the PRC in the MC95-1 decision resulted

²⁴MC95-1 Decision, page V-160.

²⁵USPS-T-31, page 14.

1 in a TYAR coverage ratio of 218 percent for Standard ECR mail.²⁶ Table 1 below summarizes
 2 the actual annual coverage ratio for ECR mail beginning with 1998 (the time period for the first
 3 rate case after the establishment of the ECR subclass) :

4 Table 1

5 **Coverage Ratios for ECR Subclass– 1998 to 2005**

	<u>Year</u>	<u>Coverage</u> <u>Ratio</u>
	(1)	(2)
6	1. 1998	240%
7	2. 1999	201%
8	3. 2000	220%
9	4. 2001	233%
10	5. 2002	224%
11	6. 2003	263%
12	7. 2004	245%
13	8. 2005	204%

14 Source: Tr. 17/5123.

15
 16 Since the institution of the ECR subclass, the actual coverage ratios for ECR mail have
 17 ranged between 201 percent and 263 percent. More importantly, as shown in Table 2 below, the
 18 actual coverage ratio for ECR mail has been dramatically different than the coverage ratios
 19 intended by the PRC in its decisions.

²⁶MC95-1 Decision, Appendix F.

Table 2

Comparison of PRC TYAR and Actual Coverage Ratios

	PRC	Year	Coverage Ratio - ECR/NECR	
	<u>Proceeding</u>		<u>TYAR</u>	<u>Actual</u>
	(1)	(2)	(3)	(4)
1. R97-1		1998	199%	240%
2. R2000-1		2001	195 %	233%
3. R2001-1		2003	201%	263%

Source: PRC decisions and Tr. 17/5123.

Note: Values reflect Commercial and Nonprofit ECR.

In the last three rate proceedings for which actual data is available, the PRC has set rates with the intention of maintaining a coverage ratio for ECR that has ranged between 195 percent and 201 percent. When actual data became available, the actual coverage ratios for ECR mail ranged between 233 percent and 263 percent.

In his testimony, Witness O’Hara proposes rates for ECR mail (commercial and nonprofit) that produce a coverage ratio of 214 percent.²⁷ For these rates, he states that after “considering all the criteria, I conclude that the rate level proposed for ECR represents an appropriate balance among them and satisfies the fairness and equity criterion”.²⁸ However, Witness O’Hara acknowledges that “neither the Postal Service nor the Commission can predict the future precisely enough to propose or recommend rates that actually result in coverages that

²⁷USPS-T-31, page 29.

²⁸USPS-T-31, page 31.

1 match those implied by their underlying analysis.”²⁹ While I agree that predicting the future is
2 difficult, ignoring the past suggests an overstatement in rates for ECR mail. Witness O’Hara
3 ignores the fact that historically the coverage ratios for the ECR subclass that have been
4 presented in TYAR analyses in the rate proceedings have understated the actual coverage ratios
5 once the actual data is available. If the coverage ratios for ECR mail proposed by Witness
6 O’Hara exhibit the same level of overstatement as has occurred historically, when the actual data
7 are known, the coverage ratios will range between 256 percent and 280 percent.³⁰

²⁹Tr. 17/5120.

³⁰The proposed coverage ratio of 214 percent multiplied by the ratio of column (4) divided by column (3) in Table 2 above. For example, the coverage ratio based on the R2000-1 difference would equal 256 percent (214 percent x 233 percent / 195 percent). Following the same procedure, the coverage ratio based on the R2001-1 difference would equal 280 percent (214 percent x 263 percent / 201 percent).

VII. HISTORICAL CHANGES IN ECR VOLUMES

Table 3 below summarizes the number of pieces of ECR mail for 1998 through 2005 and for the TYAR 2008 period developed for R2006-1:

Table 3

Volumes for ECR – 1998 through R2006-1 TYAR
(Number of Pieces in Billions)

	<u>Year</u>	<u>No. of Pieces</u>	<u>Percent Change from 1998</u>
	(1)	(2)	(3)
1.	1998	34.1	xxx
2.	1999	32.8	-4%
3.	2000	32.8	-4%
4.	2001	30.9	-9%
5.	2002	29.7	-13%
6.	2003	29.3	-14%
7.	2004	30.3	-11%
8.	2005	32.0	-6%
9.	TYAR 2008	29.3	-14%

Source: 1998 to 2005: USPS-LR-L-63, file "Volumes.xls", level GFY Volumes". TYAR (2008): USPS-T-7, page 9. Reflects volumes for Commercial ECR mail only.

Since 1998, actual commercial ECR volumes have declined from 34.1 billion pieces to 32.0 billion pieces in 2005. This represents a 6 percent decline. The 2004 and 2005 volumes reflect a slight rebound from the dramatic decline that occurred between 1998 and 2003 when the volume had decreased to 29.3 billion pieces, a decline of 14 percent from the 1998 levels.

1 Although Witness O'Hara contends that the USPS' proposed rates satisfy the criteria
2 of the Postal Reorganization Act, his proposal is not justified because it is not market based
3 and will not lead to increased volumes in the ECR subclass. The USPS' proposal is
4 projected to decrease the ECR volume to 29.3 billion pieces which is 14 percent below the
5 volume in 1998 and 8 percent below the volume in 2005.

6 As noted in USPS's Witness Thress' testimony, part of the decrease in volume is due
7 to the elimination of the automation discount for ECR mail.³¹ Even if the USPS's estimated
8 2.1 billion pieces related to the automation discount are added to the TYAR volumes, the
9 ECR volume would equal 31.4 billion pieces, a decline of 8 percent over 1998 levels and a 2
10 percent decline over 2005 levels. The wisdom of a rate structure which is designed to
11 eliminate such a substantial portion of the USPS business must be questioned.

12 In the MC95-1 proceeding, the PRC established the ECR subclass with the intention,
13 in part, of pricing to encourage the growth of volume in the subclass. Commercial ECR
14 mail, which has shown an increasing susceptibility to diversion to other forms of advertising,
15 has not grown under the historical pricing policies. This leads to the conclusion that the
16 pricing policies have been counterproductive and have not produced the best results for the
17 USPS or ECR mailers.

³¹USPS-T-7, page 117. Witness Thress expects 2.1 billion pieces of ECR mail to migrate to the Standard Regular subclass based on his Test Year Before Rate analysis.

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 and 5901 N. Cicero Avenue, Suite 504, Chicago, Illinois, 60646.

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 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. For Docket No. R2000-1, Postal Rate and Fee Changes, 2000, I submitted testimony related to the discounts for Bound Printed Matter, the cost savings associated with computer-generated postage, the relationship of the change in costs with

1
2
3 changes in weight, the differential in costs between Enhanced Carrier Route (“ECR”) letter and
4 flat shaped mail, and the differences in coverage ratios between First Class and Standard mail.

5 The firm of L. E. Peabody & Associates, Inc., specializes in solving economic, marketing
6 and transportation problems. As an economic consultant, I have participated in the direction and
7 organization of economic studies and prepared reports for railroads, shippers, for shipper
8 associations and for state governments and other public bodies dealing with transportation and
9 related economic problems. Examples of studies which I have participated in organizing and
10 directing include traffic, operational and cost analyses in connection with the transcontinental
11 movement of major commodity groups. I have also been involved with analyzing multiple car
12 movements, unit train operations, divisions of through rail rates and switching operations
13 throughout the United States. The nature of these studies enabled me to become familiar with
14 the operating and accounting procedures utilized by railroads in the normal course of business.

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

21 Over the course of the past twenty-eight (28) years, I have participated in the
22 development of cost of service analyses for the movement of coal over the major eastern,
23 southern and western coal-hauling railroads. I have conducted on-site studies of switching,
24 detention and line-haul activities relating to the handling of coal. I developed the carrier's

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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 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.