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POSTAL RATE COMMISSION
OFFICE OF THE SECRETARY

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

Special Services Reform, 1996

Docket No. MC96-3

REBUTTAL TESTIMONY
OF
W. ASHLEY LYONS
ON BEHALF OF
UNITED STATES POSTAL SERVICE

POSTAL RATE COMMISSION
DOCKETED
DEC 6 1996
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AUTOBIOGRAPHICAL SKETCH

4 My name is W. Ashley Lyons. My autobiographical sketch is presented in
5 my direct testimony, USPS-T-1.

1

2 I. Purpose of Testimony

3 The purpose of my testimony is to rebut that portion of the testimonies of
4 OCA witnesses Thompson and Sherman criticizing the selective nature of the
5 special service reforms proposed by the Postal Service, and the resulting fee
6 increases and net revenue gains. I also oppose the testimony of OCA witness
7 Callow's proposal to reduce Group 1 post office box fees.

8

9 II. OCA Witness Thompson

10 A. Prior Year Loss Recovery

11 Office of the Consumer Advocate witness Thompson argues that the fee
12 changes requested by the Postal Service in this filing should not be
13 recommended because the Postal Service does not need additional revenue to
14 achieve the target for recovery of prior years' losses set by the Board of
15 Governors. This line of reasoning is based on the faulty notion that the Board's
16 policy limits the Postal Service to recovering the target articulated in Resolution
17 No. 95-9. In fact, the Resolution directs that the Postal Service "will plan for
18 cumulative net income, in the period since implementation of the rates adopted
19 in the most recent omnibus rate proceeding, to equal or exceed the cumulative
20 prior years' loss recovery target for the same period."¹ (Emphasis added.)
21 Witness Thompson confirmed this in her response to Postal Service

¹ Library Reference SSR-112.

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1 Interrogatory USPS/OCA-T200-1 (Tr. 5/1372), but continued to focus in that
2 response on the fact that the "terms of the resolution will be met in both FY 96
3 and FY 97 without any rate increases". The only prohibition against doing better
4 than the target is in the mind of witness Thompson.

5 Consider the following situation. A football team decides prior to the
6 season that its goal is to win 10 out of 16 scheduled games. The team plays
7 better than expected and wins its first ten games. Would Coach Thompson have
8 her team deliberately lose the last six games because her pre-season goal had
9 already been accomplished? The answer is obvious. Clearly by approving both
10 the Docket No. MC96-3 filing and the FY 1997 Operating Budget, the Board has
11 taken actions aimed at doing better than the target.² The Board of Governors
12 has acted responsibly and logically by approving an operating budget that plans
13 a continuation of equity restoration during a period which has been
14 characterized by strong financial fundamentals and performance. Witness
15 Thompson's recommendation that net income should be constrained in order not
16 to exceed the minimum level of the Board's equity restoration target is illogical
17 and irresponsible.

18 Despite recent progress in restoring equity, the Postal Service's equity
19 position remains substantially negative. As I discussed in my direct testimony,
20 the Postal Service has incurred net losses, and consequently has experienced a
21 decline in equity, over all but two rate cycles since postal reorganization. The

² Library Reference SSR-152.

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21 decline in equity, over all but two rate cycles since postal reorganization, except

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1 period following the Docket No. R80-1 rate change from 1981-1984, and, so far,
2 the current rate cycle period are exceptional in that cumulative net incomes have
3 been generated. Postal Service equity declined from \$1.7 billion, when it began
4 operations on July 1, 1971, to a negative \$6.0 billion at the end of FY 1994.
5 Since then, the Postal Service has begun to reverse this trend. Through the end
6 of FY 1996 equity has improved to a negative \$2.6 billion. Although this
7 represents a significant improvement, there is still a long way to go before equity
8 is returned to a positive position as it was when the Postal Service was
9 established 25 years ago. The plain fact of the matter is that the Postal Service's
10 equity remains substantially negative and there is no certainty that equity can
11 continue to be restored over future rate cycles. I believe the responsible course
12 of action is to restore additional equity now that will mitigate general rate
13 increases in the future. The revenue reforms proposed in this docket do just that
14 and are consistent with our legal mandate and sound business practice.

15 **B. Selective Rate Increases and Net Revenue Neutrality**

16 OCA witness Thompson also seems to argue that changes in rates and
17 fees that result in additional net revenue should not be recommended outside of
18 an omnibus rate case. She does admit in her response to interrogatory
19 USPS/OCA-T-200-2 (Tr. 5/1373-75), that "not all future classification cases must
20 be net revenue neutral", but fails to define in what classification cases net
21 revenue increases should be recommended. She further avoids specifying

1 for the period following the Docket No. R80-1 rate change from 1981-1984, and,
2 so far, the current rate cycle period. These periods are exceptional in that
3 cumulative net incomes have been generated. Postal Service equity declined
4 from \$1.7 billion, when it began operations on July 1, 1971, to a negative \$6.0
5 billion at the end of FY 1994. Since then, the Postal Service has begun to
6 reverse this trend. Through the end of FY 1996 equity has improved to a
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21 be net revenue neutral", but fails to define in what classification cases net
22 revenue increases should be recommended. She further avoids specifying

1 beyond broad outlines what cases need not be net revenue neutral in her
2 responses to USPS/OCA-T-400-21 (Tr. 5/1405-07) and USPS/OCA-T-200-33
3 (Tr. 5/1408-10). During oral testimony, witness Thompson was unable to provide
4 precise information to clarify her position. See Tr. 5/1478-1500. Her
5 explanations are confusing and not persuasive.

6 It is not reasonable to assume that individual classification reform
7 proposals and their objectives can or should always await an omnibus rate case,
8 or be accomplished on a net revenue neutral basis. Such an approach could
9 lead to illogical actions. In general, the way to establish new services or reform
10 existing services for which fees are too low to reflect market demand or other
11 pricing criteria, is to set a new fee or increase the existing fee and thereby
12 increase net revenue. For example, the stamped card special service is new
13 and therefore adds net revenue. Witness Thompson generally desires that any
14 fee or rate increase be offset by a decrease in some other fee or rate. Sound
15 classification and pricing reforms that result in additional net revenue
16 presumably would have to be offset by other reforms that would result in a net
17 revenue loss. It does not make sense to spend time and resources searching for
18 ways to justify revenue reductions just for the sake of achieving a short term net
19 balance. Such an approach is not likely to make the customer subject to an
20 increase feel any better, and would be inconsistent with Postal Service goals of
21 net revenue generation and equity restoration. There is no reason to force the

1 concept of revenue neutrality onto all reform proposals when additional net
2 revenue is a consequence of reform.

3 Witness Thompson also contends that Docket No. MC95-1 somehow
4 committed the Postal Service to a perpetual, inflexible, and irrevocable policy of
5 net revenue neutrality in all future cases involving reform of rates or
6 classifications. She believes that the "framework" mentioned in the Request, at
7 page 2, refers to contribution neutrality. See Tr. 5/1373-74. She is mistaken.
8 The "framework" for classification reform to which she refers actually relates to
9 redefining the classes of mail to reflect different service levels desired by
10 customers. Docket No. MC95-1 Request, page 2 (Tr. 5/1414). The Postal
11 Service has never committed itself to a policy of net revenue neutrality for all
12 rate cases outside of omnibus cases.³ To have done so would have severely
13 limited the options available to satisfy the Board of Governors goal expressed in
14 Resolution 95-9, breaking even over time and restoring equity.

15

16 III. OCA Witness Sherman

17 OCA witness Sherman maintains that Docket No. MC96-3 is "unusual"
18 because the Postal Service proposes "price increases on a piece-meal basis
19 rather than in context, as in an omnibus rate case, where all rates for all services
20 can be compared." OCA-T-100 at 3, Tr. 7/2274. Witness Sherman argues that
21 the changes proposed in this docket should be evaluated in the context of an

³ Witness Thompson was unable to identify a specific citation in the MC95-1 Request where the Postal Service explicitly made such a commitment. See *generally* Tr. 5/1437-38, 1446-47, and 1450.

1 omnibus rate proceeding, so that the Commission can make comparisons across
2 services and recommend equitable contributions. OCA-T-100 at 4, Tr. 7/2275.

3 Although witness Sherman insists upon an omnibus rate proceeding, he
4 concedes that it is possible to compare existing relative price relationships with
5 those suggested by a Ramsey model or, for example, a uniform markup model,
6 whether one is proposing (or even contemplating) a change in all rates, many
7 rates, few rates, or no rates. But witness Sherman presents one caveat: in
8 order to compare existing relative price relationships, "all necessary data must
9 [be] available" outside omnibus rate proceedings. Tr. 7/2350. Each criticism is
10 addressed in turn.

11 A. Data Availability

12 Witness Sherman ignores the fact that data are available in this docket to
13 make precisely the type of comparisons he contends the Commission must make
14 when evaluating the proposals in this docket. For instance, witness Patelunas's
15 Exhibits USPS-T-5G and USPS-T-5J present cost coverages for the various
16 postal products and services both before and after the implementation of the
17 proposed rates for the special services. These data provide ample information
18 about cost and revenue relationships between and among the various postal
19 products and services.

20 Indeed, it appears witness Sherman's criticisms in this docket stem more
21 from his own limited experience, rather than from an objective evaluation of
22 either the availability of data or the process that is undertaken by the

1 Commission in recommending new fees and rates. For instance, when asked
2 whether the Commission has evaluated all rates in past dockets, Dr. Sherman
3 professed having no knowledge of "piecemeal cases." Tr. 7/2461. When
4 pressed, Dr. Sherman conceded that the Commission has recommended rates
5 or classifications without reviewing rates for every other category, but claimed
6 that "[t]here was agreement on what the aims were in those cases. They were
7 classification cases that involved no revenue change." Tr. 7/2461. A review of
8 past dockets reveals that revenue neutrality is not necessarily an inherent
9 characteristic of classification cases. For instance, in Docket No. MC96-2, the
10 Postal Service proposed, and the Commission recommended, fees that
11 generated a test year loss of contribution in excess of \$20 million and an
12 anticipated FY 97 loss much greater than that.

13 B. The Fear Of Distorting the Present Cost-Price Relationships

14 Witness Sherman has also alluded to the possibility that piece-meal
15 changes in rates and fees may result in distortions to a Ramsey model, or some
16 other form of relative relationship, when selected services are chosen for
17 increased prices. Tr. 7/2351-52. Dr. Sherman readily concedes that his criticism
18 is premised upon the assumption that all rates and fees were "in line" with
19 Ramsey pricing or some other deliberate approach to establishing price-cost
20 relationships. Tr. 7/2351. Dr. Sherman's argument is unpersuasive, however,
21 because it appears to be based on the mistaken premise that the Commission
22 uses a mechanical formula or rigid economic theory in determining rates. This

1 has been explicitly rejected by the Commission. As recently as the last omnibus
2 rate case, Docket No. R94-1, the Commission affirmed that it had adopted no
3 deliberate approach, Ramsey or otherwise, in establishing price-cost
4 relationships. In Appendix F to the Commission's Opinion in that Docket, the
5 Commission explained that:

6 [n]o one pricing theory, economic or otherwise, serves as the
7 dominant principle in the Commission's pricing decisions. This is
8 consistent with the Act, as interpreted by the courts. *Newsweek,*
9 *Inc. vs. U.S. Postal Service*, 663 F.2d 1186, 1200 (2d Cir. 1981).
10 Deciding markups and developing rate recommendations involves
11 balancing a number of statutory pricing criteria, some of which
12 complement each other and some of which conflict with each other.
13 The task of recommending rates is difficult because, in contrast to
14 costing analyses, economic theory offers guidance on only a few of
15 the nine pricing criteria of section 3622(b). Few of these criteria are
16 quantifiable through mathematical modeling. As a result, the
17 guidance that economic theory offers is mostly qualitative.
18 Selecting a single set of rates that satisfies all of the pricing criteria
19 requires the Commission to judgmentally determine how to
20 interpret the various pricing criteria and the weight to be accorded
21 to each.⁴
22

23 The above passage demonstrates that the Commission has relied upon
24 its judgment in making recommendations in accordance with the statutory pricing
25 criteria on rates and fees. As such, the Commission has not applied a
26 mechanical formula or an economic theory, such as Ramsey pricing, to assign
27 contributions. While the Postal Service believes that Ramsey pricing can
28 provide a useful analytic framework, judgment is an inevitable part of the
29 process and ultimately there is no precise science to assigning contributions in

⁴ Docket No. R94-1, Opinion and Recommended Decision, Appendix F at 17.

1 postal ratemaking. Nothing precludes the Commission from exercising its
2 judgment in making recommendations on a subset of rates and classifications
3 without engaging in a wholesale review of all other categories.

4

5 IV. OCA Witness Callow

6

7 OCA witness Callow recommends that Group 1 post office box fees be
8 reduced instead of increasing the fees as proposed by the Postal Service. This
9 OCA proposal should be rejected. For the reasons discussed in witness Lion's
10 testimony (USPS-RT-3) I believe there is a high probability that the new Group 1
11 box customers predicted by witness Callow to result from his proposed lower
12 fees will not materialize.

13 As explained by witness Lion in his rebuttal testimony, post office boxes
14 are frequently not readily available in those areas where demand is the highest.
15 Witness Lion also explains that the cost of adding new boxes in these areas is
16 higher than the average cost of post office boxes reflected in the Cost and
17 Revenue Analysis (CRA). This is because CRA post office box attributable
18 costs for facility space reflect booked costs for rent and depreciation. The
19 booked cost of facility space is generally below market rental rates since
20 appreciation in market value is not accounted for by straight line depreciation or
21 long term rental contracts. The current market cost of real estate that would
22 have to be incurred to add additional space for new boxes is higher than CRA
23 attributable costs, as discussed by witness Lion. It is my belief that current post

1 office box rates have hampered box expansion in many areas and lower box

2 rates will exacerbate this problem.

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