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ORDER NO. 1126

UNITED STATES OF AMERICA
POSTAL RATE COMMISSION
WASHINGTON, D.C. 20268-0001

Before Commissioners: Edward J. Gleiman, Chairman;
W.H. "Trey" LeBlanc III, Vice-Chairman;
George W. Haley and H. Edward Quick, Jr.

Special Services Fees and Classifications Docket No. MC96-3

ORDER DENYING MOTION TO RECONSIDER ORDER NO. 1120

(Issued July 19, 1996)

The Postal Service filed its Request for a Recommended Decision in this docket on June 7, 1996. In its filing, the Postal Service proposes for the first time to substantially increase its overall system net revenue outside of an omnibus rate case. It proposes increases in a subset of special service fees which, if they had been in effect throughout FY 1996, would increase net revenue by almost \$340 million. The Postal Service offers this impact on net revenue as one of the principal purposes of the rate and classification changes that it requests. USPS-T-1 at 6-7, 9-11.

On June 18, 1996, the Commission issued Order No. 1120. It directs the Postal Service to provide versions of USPS-T-5A-J and USPS-T-1 Exhibit C that are consistent with the cost attribution methods that the Commission applied in Docket No. R94-1, the most

JUL 19
OFFICE OF THE SECRETARY

recent omnibus rate proceeding.¹ Its purpose is to provide the parties and the Commission with a measure of the impact of the Postal Service's proposals on the costs, and institutional cost burdens of the classes and subclasses of mail that is consistent with attribution methods established in Docket No. R94-1. Such a measure is needed to allow the parties and the Commission to evaluate the effects of the Postal Service's proposed changes in fees separately from the effects of its proposed departures from established attribution methods.

The Postal Service filed a motion for reconsideration of Order No. 1120 on June 28, 1996. Motion of the United States Postal Service for Reconsideration of Order No. 1120, and Partial Response (hereafter, "Motion"). In it, the Postal Service argues that it may choose the methods by which it estimates the cost and cost coverage consequences of its proposals. It also contends that a cost presentation that conforms to the attribution methods applied in Docket No. R94-1 is not needed. It argues that the issues raised by its limited proposals are circumscribed, and that the appropriateness of such proposals under the Act can be evaluated without considering their relationship to, or their impact on, the cost coverages for the various classes and

¹ The Postal Service's Request departs from past practice for interim filings by not using the same base year and test year that were used in the most recent omnibus rate proceeding. The Order noted that the Postal Service also departed from recent practice by developing its base year costs solely by the methods that the Postal Service uses in its own Cost and Revenue Analysis Report (CRA), without regard to the methodological precedents established in the most recent omnibus rate proceeding. PRC Order No. 1115 (June 12, 1996) at 4.

subclasses of mail. Motion at 6, 9-11. Major Mailers Association (MMA)² and the Office of the Consumer Advocate (OCA)³ oppose the Motion.

The Postal Service argues, first, that the costs and cost coverages of the subset of special services for which it proposes to change rates would not vary significantly if the Commission's, rather than the Postal Service's attribution methods were applied. In Attachments A through C to its Motion, the Postal Service provides a comparison of the differences in attributable costs and cost coverages for the various subclasses and special services for the FY 1993 base year used in Docket No. R94-1. Motion at 4. According to these Attachments, the differences in cost coverages among the directly affected special services were less than four percent, except for Special Delivery. The Postal Service contends that except for Special Delivery, these differences are inconsequential. It argues that the differences

² Major Mailers Association's Response to the Postal Service Motion for Reconsideration, filed July 15, 1996 ("MMA Response"). MMA's Response is accompanied by motions for late intervention and for filing its Response out of time. MMA explains that the issue of documenting effects of Postal Service proposals according to established attribution methods affects its interests, and that this issue was not clearly raised in this docket until the Commission issued Order No. 1120. It argues that it responded to Order No. 1120 as quickly as it could with requests for intervention and for leave to respond. Major Mailers Association's Motion Requesting Permission to File a Notice of Intervention Out of Time, July 15, 1996. This appears to be a legitimate cause of delayed participation. Accordingly, MMA's motions will be granted.

³ Office of the Consumer Advocate Opposition to Motion of the United States Postal Service for Reconsideration of Order No. 1120, July 8, 1996 ("OCA Opposition").

for Special Delivery are irrelevant, since it proposes to eliminate this service. Id. at 5.

The Postal Service does not contend that the effect on cost coverages for the regular subclasses of mail would be insignificant if it had applied established R94-1 attribution methods rather than its own. Instead, it argues, that it is sufficient under the Act and the Commission's rules to evaluate proposals for limited rate and classification changes without reference to the cost coverages of other classes and subclasses of mail. It asserts that the merits of its proposals can be adequately assessed by simply comparing the proposed cost coverages among the affected special services. It supports its contention by noting that the Commission in the past has generally evaluated the proposed cost coverage for a given special service by comparing it to its historic coverage, or to the systemwide average. Motion at 8. It adds that the classification reforms that are scheduled to go into effect in the FY 1996 test year are likely to alter the cost relationships among classes and subclasses of mail from those that were estimated when the established Docket No. R94-1 attribution methods were last applied. This, it argues, makes cost coverages calculated according to methods established in R94-1 even less relevant to its proposals in this docket. Id. at 9.

The Postal Service asserts that its Request fully complies with Rule 54 of the Commission's Rules of Practice, and that more cost information is not needed. It contends that Rule 54 requires it to present total actual and estimated accrued costs, but imposes no requirement as to how they are calculated. It

argues that a party should not be required to estimate the impact of its proposals on costs and cost coverages "only in a specific, prescribed manner." Id. at 9, n.11. It maintains that it has provided enough cost information to allow the Commission to estimate these impacts according to the Commission's attribution methods. Id. at 11.

Finally, the Postal Service argues, attributing costs in this docket according to established methods would be "unduly burdensome and may not even be possible." Id. at 11-12. Attachment D to the Motion is a declaration by Postal Service witness Richard Patelunas that describes the steps that would be required to modify the Postal Service's base year and test year costs to conform to the methods used by the Commission in its Further Recommended Decision in Docket No. R94-1. He concludes that the effort could take from 10 to 15 man-days. Declaration, para. 11. Attachment C to the Motion compares cost coverages in the R94-1 base year (FY 1993) calculated according to the Postal Service's and the established Commission attribution methods. The Motion suggests that the Commission derive ratios from this comparison and apply them to base year data in this docket as a short-cut approach to measuring the impact of its proposals according to the Commission's attribution methods. Motion at 2.

Scope of issues raised by the Request. It is not necessary to decide in this Order whether there could be proposals for changes in rate or classification provisions that are so limited that their appropriateness under the standards of the Act can be determined in isolation. It is only necessary to determine

whether the proposals in this Request are sufficiently circumscribed. The Commission concludes that they are not.

In previous dockets, a proposed fee for a given special service often was presented as a routine, periodic realignment of the fee with the underlying attributable costs of that service. In these instances, the Commission often considered systemwide cost coverages in evaluating a proposed fee, but it usually emphasized the relationship of the proposed fee to its historic level and cost coverage. In this docket, the Postal Service proposes to increase the total annual institutional cost contribution from a subset of special services by \$340 million, an increase of over 260 percent.

The Postal Service makes it clear that it does not view its Request as a routine realignment of fees of the affected special services with costs. A major goal of this Request, according to the Postal Service, is to shift a substantial portion of the system's institutional cost burden onto this subset of special services as part of its new "demand pricing" business strategy, and to use the increased contribution to recover Prior Year Losses, or to delay rate increases for other mail services. USPS-T-1 at 6, 9-11.

The Postal Service's Request, therefore, proposes dramatic changes not just in the magnitude of the revenue burdens of the affected special services, but in the rationale supporting those changes. Such changes unavoidably raise issues of the appropriateness of the relative revenue burdens and cost coverages that the proposed system would exhibit. The consistency of these proposed fees with the pricing standards of

the Act, including §§ 3622(b)(1), (b)(3), and (b)(5), cannot be assessed without accurate estimates of their impact.⁴

The Motion asserts that the Act does not require that rates be adjusted simultaneously for the entire system, and that a request may propose changes in a subset of rates without requiring a comprehensive evaluation of costs and rates for all mail categories. The Motion implies that Order No. 1120 requires such an examination. Motion at 6. Order No. 1120 does not require a reevaluation of attributable cost estimates or institutional cost burdens resulting from rates and fees other than those proposed in the Request. It merely requires that the Postal Service demonstrate what attributable costs and institutional cost burdens would prevail under its proposals in the test year, if they were measured by the same methodological "yardstick" established as the standard in the most recent omnibus rate case.

Measuring the effects of its proposals by established methods will make it less difficult to compare the relative cost coverages that would result from the Postal Service's proposed fee changes with those that most recently underwent comprehensive review for consistency with the statutory pricing factors (those implemented as a result of the Further Recommended Decision in

⁴ That the changes proposed to special services would have a significant effect on the system as a whole is also illustrated by their impact on attributable costs. Appendix B to USPS-T-5 estimates that the shift of volume from lockboxes to street delivery as a result of the proposed increases in lockbox fees will increase carrier costs by approximately \$86 million, \$84 million of which is attributed to the classes and subclasses of mail, rather than to special services.

Docket No. MC96-3

- 8 -

Docket No. R94-1). The cost coverage evaluations articulated in R94-1 provide the legal foundation of the "before rates" rate relationships that are assumed to prevail in the test year in this docket.

Compliance with Rule 54. The Postal Service contends that it has fully complied with the Rule 54 requirement that it present estimates of total actual and estimated accrued costs for various years. It asserts that Rule 54 does not require that its estimates be presented "in a particular manner or in accordance with a particular costing methodology." Motion at 9. It argues that additional costing information is not warranted. *Id.* at 9-10.

Rule 54 requires an itemization of costs by account and a distribution of those costs to functions and subfunctions. Because it is a generic rule, it does not require that this process be carried out by specified methods for particular functions. It allows for diverse costing methods to be used at any one time, and the evolution of costing methods over time.

Although the Commission did not base Order No. 1120 on the Postal Service's obligations under Rule 54, the objectives of Order No. 1120 and those of Rule 54 are consistent. Rule 54(a)(1) requires that:

[e]ach formal request filed under this subpart shall include such information and data and such statements of reasons and bases as are necessary and appropriate fully to inform the Commission and the parties of the nature, scope, significance and impact of the proposed changes or adjustments in rates or fees and to show that the changes or adjustments in rates or fees are in the public interest and in accordance with the policies of the Act and the applicable criteria of the Act.

These general provisions of Rule 54, under any reasonable interpretation, require that each Request include enough information to allow the parties and the public to determine what the impact of the Postal Service's proposals on system costs, volumes, and revenues would be. It could be argued that to adequately "inform the Commission and the parties of the nature, scope, significance and impact of the proposed changes or adjustments in rates or fees," the Postal Service's Request should have provided the presentation required by Order No. 1120. The Commission has not pressed this interpretation of Rule 54 in the past, and did not base Order No. 1120 on it.

It should be noted, however, that the Postal Service's Request leaves the parties to determine for themselves what the relative cost coverages under the Request would be if they were measured by established attributable cost definitions and methods. Unless they did further analytical work on their own, the parties could not determine what the relative cost coverages under the Request would be if they were measured by definitions and methods that are consistent with precedent, and, therefore, most likely to apply in this docket. Nor could they determine how the relative cost coverages under the Request compare with those that have formed the legal basis of past rate schedules. Because the Postal Service's Request does not include such a standard reference point, parties and the public would have to make complex adjustments to the Postal Service's cost presentation of the kind that witness Patelunas describes in Attachment D to the Motion, in order to derive costs and cost coverages under the proposed regime that are comparable to those

measured by established methods. Failing to provide such a standard reference point may not violate the letter of Rule 54, but it frustrates the Rule's basic objectives.

The role of precedent. One of the Commission's primary responsibilities under the Act is to evaluate rate relationships among the classes and types of mail service. Among the factors that the Commission must use to evaluate these relationships are the accuracy with which attributable costs have been estimated and the reasonableness of the assignment of other costs to the various mail services [§ 3622(b)(3)], the fairness of the resulting rate relationships [§ 3622(b)(1)], and whether the various mail services have reasonably-priced alternatives [§ 3622(b)(5)].

Rate relationships measured by definitions and methods that have been established as authoritative precedent during the course of litigation provide the only consistent reference point from which the impact of proposed changes can be determined. To determine the impact of proposed rate changes on costs and cost coverages, the starting point must be a consistent definition of attributable costs. Unless consistent attribution definitions and methods are applied, the impact of the Postal Service's Request on the status quo cannot be reliably determined.

The Commission's authority to select the definitions and methods by which the cost basis of rates will be determined and the reasonableness of institutional cost burdens will be evaluated, derives from its duties to apply the rate setting criteria of § 3622(b). Under the Act, the Commission is to base

its rate recommendations on nine factors. Chief among them is § 3622(b)(3), which states

the requirement that each class of mail or type of mail service bear the direct and indirect postal costs **attributable** to that class or type plus that portion of all other costs of the Postal Service **reasonably assignable** to such class or type; (emphasis added)

To determine what costs are "reasonably assignable" to classes and types of service, "attributable" costs must first be determined. As the OCA observes in its Opposition to the Motion, at 2-3, it is the Commission's responsibility to establish the definitions and methods used to determine attributable costs. In *National Association of Greeting Card Publishers v. USPS*, 462 U.S. 810, 833 (1983), the Supreme Court held that

all costs that **in the judgment of the Rate Commission** are the consequence of providing a particular class of service must be borne by that class. The statute requires attribution of any cost for which the source can be identified, **but leaves it to the Commissioners, in the first instance, to decide which methods** provide reasonable assurance that costs are the result of providing one class of service. (emphasis added)

Thus, the Supreme Court recognized that attributable and institutional costs need to be determined by a consistent set of principles, and where the Commission and the Postal Service are in disagreement, the Commission has the primary role in determining those principles.

To carry out its duty to provide a consistent set of cost attribution principles, the Commission attaches precedential weight to pertinent attributable cost definitions and methods

applied by the Commission in the most recent proceeding in which they were litigated. In most instances, these will be the definitions and methods applied by the Commission in the most recent omnibus rate proceeding. The currently applicable precedents are found in the Commission's Further Recommended Decision in Docket No. R94-1.

The Postal Service's Motion, at 10, suggests that it advocates not only replacing current fees with proposed fees, but established attribution methods with proposed attribution methods. Part of the Postal Service's burden as advocate of these simultaneous changes is to demonstrate the impact of its proposed fee changes on the status quo, measured by methods consistent with the status quo. It should not be left to the parties or the Commission to disentangle the effect of the Postal Service's proposed changes to established attribution methods from the effects of its proposed changes in fees. The presentation required by Order No. 1120 is the threshold showing that the Postal Service would have to make in order to carry its burden of separately demonstrating the effect of its proposed fee changes from the effect of its proposed changes in attribution methods.

In meeting this burden, the Postal Service is not required to affirm the theoretical soundness or the practical wisdom of the established methods. It is merely required to affirm that it has provided the parties and the Commission with its best estimate of what the consequences of its proposed changes would be, measured by established costing principles. Meeting this burden, of course, does not preclude the Postal Service from

proposing to measure the cost impacts of its proposals by alternative methods.

Unwarranted burden. The Motion argues that except for Special Delivery, cost coverages for special services resulting from its proposals would not vary significantly if they were measured by established methods. In the prehearing conference conducted on July 12, 1996, the American Postal Workers Union indicated that it is opposed to settling the issue of whether Special Delivery service should be eliminated. Tr. 1/13. In its Opposition to the Motion, the OCA observes that as long as this issue is unresolved, the Commission has a duty to determine whether eliminating Special Delivery is in conformance with the Act. It notes that this may require an evaluation of the cost coverage of Special Delivery, which depends to a large degree on the method used to measure its attributable costs. Therefore, it asserts, a need remains to measure its attributable costs in a manner consistent with precedent. OCA Opposition at 5. The Commission agrees.

Attributing costs by different methods can be expected to have a significant effect on the relative cost coverages among mail services other than special services. The comparison that the Postal Service provides in Attachment C to its Motion based on FY 1993 data roughly illustrates the magnitude of the potential effects. Based on those attributable cost comparisons, the institutional markup index numbers for third-class bulk regular rate mail go from .930 under the Postal Service's proposed attribution methods to .831 under established methods. The index numbers for First-Class letters and Priority Mail move

in the opposite direction, going from 1.332 to 1.353, and 1.721 to 1.858, respectively.

Effects of this magnitude have a potential impact on the evaluation of the fairness of the institutional cost burdens proposed for special service customers relative to those borne by customers of other services. The suggestion in the Motion that the Commission should be satisfied with adjusting the Postal Service's test year attributable costs in this docket by ratios derived from Attachment C still would leave the parties and the public guessing as to the result if established methods were applied to FY 1995 cost data and rolled forward. Because this uncertainty is reasonably avoidable, it should be remedied.⁵

⁵ The Postal Service also asserts that classification changes scheduled to take effect in the last quarter of the FY 1996 test year may be expected to cause shifts in attributable costs and cost coverages among the subclasses, introducing uncertainty as to the true nature of those relationships in the test year under either attribution method. Motion at 9. Even though the Postal Service itself has chosen to disregard these potential shifts in constructing its test year, the Postal Service's point is well taken. Adjusting for them at the same time that the established attribution methods are applied would move its attributable cost estimates closer to the ideal. The Commission encourages such adjustments. It is worth noting that the major one - using single subclass stop analysis to attribute access costs - is readily adaptable to reclassification. The CCS data needed is already separately gathered for carrier route third-class mail, which is closely analogous to the new Enhanced Carrier Route subclass. Therefore, no proxies need to be developed to reflect the only new subclass scheduled to be implemented in the test year. There may be obstacles to projecting the effects of the multitude of new discounts in the test year that the Commission has not considered. Therefore, applying established attribution methods to the test year, as the Postal Service has already constructed it, is the minimum cost

The Motion describes the steps required to adjust the Postal Service's cost presentation to conform to established attribution methods, and concludes that it would require ten to fifteen man-days of effort. This burden is not excessive. The effects of applying different attribution methods on the Postal Service's estimates of relative institutional cost burdens are likely to be significant. Without such a presentation, these potentially significant effects cannot be separated from the effects of the Postal Service's proposed changes in fees. Accordingly, the Postal Service is directed to provide the requested presentation within fifteen days of the date of this Order, but is strongly encouraged to provide it prior to that time, if possible.

The Motion raises the prospect that to make the necessary adjustments, judgment may be required at some as yet unidentified stage. Motion at 14. The Postal Service has already demonstrated its ability to make the base year adjustments necessary to conform to the established attribution methods. See Docket No. MC93-1, USPS-LR-SP-19, PRC Version of Audited 1992 CRA and accompanying workpapers. It has also demonstrated its ability to make the necessary adjustments to the roll-forward process to a high degree of precision, using less current data. See Docket No. MC95-1, Exh. USPS-14I, Comparison of USPS Replication of Test Year 1995 and Commission Library Reference

presentation that is required. Adjustments to reflect reclassification are welcome.

PRC-LR-9.⁶ A good faith effort to do the same with respect to the more current data in this docket is all that is required.

It is ordered:

(1) The Postal Service is directed to provide the cost presentations specified in Order No. 1120 on or before August 5, 1996.

(2) The Major Mailers Association's Motion Requesting Permission to File a Notice of Intervention Out of Time, filed July 15, 1996, is granted.

(3) The Major Mailers Association's Motion Requesting Permission to Reply Out of Time to Postal Service's Request for Reconsideration of Commission Order No. 1120, filed July 15, 1996, is granted.

By the Commission:

(S E A L)



Margaret P. Crenshaw
Secretary

⁶ In this Exhibit, the Postal Service's replication of the Commission's attribution methods produced an estimate of FY 1995 test year total attributable costs that was within four ten-thousandths of a percent of the Commission's estimate. This degree of accuracy was achieved without the benefit of the exhaustive review of the Commission's cost attribution and roll-forward methods that was subsequently issued in the Commission's Opinion and Further Recommended Decision in Docket No. R94-1.