

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

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POSTAL RATE COMMISSION
OFFICE OF THE SECRETARY

POSTAL RATE AND FEE CHANGES, 2000

Docket No. R2000-1

INITIAL COMMENTS OF THE UNITED STATES POSTAL SERVICE
IN RESPONSE TO
NOTICE OF INQUIRY NO. 2

In Notice of Inquiry No. 2 (NOI 2, April 21, 2000), the Commission seeks further comments on the appropriate uses in this docket of FY 1999 actual cost and revenue data.¹ On March 15, 2000, the Postal Service lodged with the Commission the unaudited FY 1999 CRA Report (PRC Version), and on April 4, it filed the audited Report (USPS Version). On March 31 and April 19, 2000, the Postal Service filed billing determinants for FY 1999. NOI 2 now essentially asks whether these data

¹In Notice of Inquiry No. 1 (NOI 1, Feb. 2, 2000), the Commission requested a status report and comments on the availability and use of the FY 1999 Cost and Revenue Analysis (CRA) Report and billing determinant data for FY 1999. The Postal Service and several parties filed comments. See Status Report of the United States Postal Service Regarding FY 1999 Data in Response to Notice of Inquiry No. 1 (Feb. 14, 2000)(USPS Status Report on NOI 1); Initial Comments of the United States Postal Service in Response to Notice of Inquiry No. 1 (Feb. 23, 2000)(USPS Initial Comments on NOI 1); Response of the Alliance of Nonprofit Mailers to Notice of Inquiry No. 1 Concerning Base Year Data (Feb. 23, 2000)(ANM Comments on NOI 1); Comments of the Newspaper Association of America on Notice of Inquiry No. 1 (Feb. 23, 2000)(NAA Comments on NOI 1); Association of American Publishers Comments in Response to Notice of Inquiry No. 1 Concerning Base Year Data (Feb. 23, 2000)(AAP Comments on NOI 1); Association for Postal Commerce Comments on Notice of Inquiry No. 1 (Feb. 23, 2000)(Postcom Comments); Comments on Issues Identified in NOI-1 by the Coalition of Religious Press Associations (Feb. 10, 2000)(CRPA Comments on NOI 1); Office of the Consumer Advocate Comments in Response to Notice of Inquiry No. 1 Concerning Base Year Data (Feb. 23, 2000)(OCA Comments on NOI 1).

should be used to create a new base year. The Commission is also particularly interested in the need for commitment of additional resources to pursue that objective.

NOI 2 raises two key issues related to the creation of a new base year: (1) the effects of substituting a FY 1999 base year on the procedural schedule and due process; and (2) the substantive effects of a new base year on test year estimates. In both respects, the Postal Service submits that the probable consequences militate strongly in favor of retaining the FY 1998 base year, as embodied in the Postal Service's Request and testimony. On one hand, creation of a new base year would potentially undermine the Commission's dual obligations to afford due process to the Postal Service and other parties, and to respond to the Postal Service's Request for recommendations on new rates within the required ten months. On the other hand, particularly in light of the effect on due process, substituting FY 1999 as the historical base would not be warranted by a comparison between the FY 1999 CRA and the estimates for that year in the Postal Service's original filing.

Schedule and Due Process Effects

At the outset, it bears noting once again that the Postal Service's original filing did not ignore more recent data from FY 1999 in estimating costs, volumes, and revenues for the FY 2001 test year, and in formulating rate and fee proposals. In its responses to NOI 1, the Postal Service acknowledged that its Request and testimony had incorporated FY 1999 data, where such use was feasible and compatible with accepted methodologies and practices for projecting test year estimates.² Furthermore,

² See USPS Status Report on NOI 1, at 1-2; USPS Initial Comments on NOI 1, at 1-2.

contrary to suggestions made by some parties in commenting on NOI 1,³ the Postal Service's reliance on FY 1998 as the base year was neither inappropriate under the Commission's rules, nor an effort to avoid the consequences of more recent FY 1999 data.

Since those initial comments, the Postal Service has explained more fully the extent and logic of its use of FY 1999 data. Shortly before NOI 1 was issued, United Parcel Service (UPS) asked every Postal Service witness individually to indicate how such data were used. Each witness responded⁴, and participants and the Commission have had an opportunity to explore those answers through further discovery and cross-examination.

Beyond the current status of FY 1999 actual data, NOI 2 notes that its further use is likely to "entail some additional calculations." NOI 2, at 2. In the context of proposals to create a new base year, however, the consequences would be far more extensive than that phrase suggests. The base year has no independent utility in prospective ratemaking. Rather, it is used to produce test year estimates by *classification of mail, which are essential, not only for the recommendation and*

³ See AAP Comments on NOI 1, at 2-3; CRPA Comments on NOI 1, at 1-2; Postcom Comments on NOI 1, at 2-5; OCA Comments on NOI 1, at 1-2.

⁴ The following Postal Service witnesses have indicated some direct or indirect reliance on FY 1999 data: Bernstein (UPS/USPS T41-1); Crum (UPS/USPS T27-1); Daniel (UPS/USPS T28-1); Davis (UPS/USPS T30-1); Eggleston (UPS/USPS T26-1); Fronk (UPS/USPS T33-1); Kaneer (UPS/USPS T40-1); Mayes (UPS/USPS T32-1); Kingsley (UPS/USPS T10-4); Kashani (UPS/USPS T14-1); Kay (UPS/USPS T23-5); Kiefer (UPS/USPS T37-1); Mayo (UPS/USPS T39-1); Miller (UPS/USPS T24-1); Moeller (UPS/USPS T35-1); Musgrave (UPS/USPS T8-4); Plunkett (UPS/USPS T36-1); Robinson (UPS/USPS T34-2); Taufique (UPS/USPS T38-1); Tayman (UPS/USPS T9-1); Thress (UPS/USPS T7-1); Tolley (UPS/USPS T6-9); Yacobucci (UPS/USPS T25-1). Most of these responses were filed February 24, 2000.

assessment of specific rate and fee changes, but for a realistic evaluation of the revenue consequences of those changes. The effects on the record and procedural schedule of establishing a new base year, therefore, can only be evaluated in the context of producing entirely new test year estimates. Because of the nature of the roll-forward process, furthermore, there is no precise way of predicting what the ultimate test year estimates will be without actually running the roll-forward model using both a new historical base and, in all likelihood, new roll-forward factors. This will require *considerable time and effort.*

In this regard, it cannot realistically be expected that updating the base year for FY 1999 actual results could take place without reevaluating the roll-forward itself. All of the sources of change that affect future expenses and revenue needs would have to be assessed, and the roll-forward factors potentially revised, if only to conform to the controlling principle of relying on the most recently available information. Any attempt only to partially account for updated information would create the risk that the resultant distributions of costs and revenues among mail classifications and special services would be distorted. At a minimum, the following changes would have to be considered:

- The design of the linked spreadsheet models used to calculate the roll-forward factors would have to be reconsidered and revised.
- Inputs to these models, to the extent they have been overtaken by more recent information, would have to be changed.
- Inputs derived from program estimates, such as other programs and cost reductions, would have to be redeveloped. Estimates that were originally made in relation to historical information for FY 1998 and future estimates for FYs 1999 through 2001 would have to be reassessed in light of new data and actual financial results. New program estimates would have to be reviewed, validated, and approved by postal management.

- Cost avoidance models used to develop final adjustments would have to be reviewed and probably updated for FY 1999 data.
- Workyear mix adjustments for the test year would have to be reconsidered and revised.

It is difficult to estimate precisely the time it would take for the Postal Service to develop new test year estimates from a FY 1999 base year. In preparing its cases for filing, the Postal Service would consider all of the measures outlined above, as well as others, to be prerequisites. Even if updates for more recent information were only partially incorporated, developing estimates from a revised base year would take considerable time. For example, we estimate that, if the roll-forward were not updated for the most recent inflation forecasts, which would otherwise affect such inputs as wage and benefit levels and volume projections, the exercise of developing new test year estimates would take somewhere between six to ten weeks. This includes time to create some documentation, but it would be impossible in that time to duplicate the level of documentation required by the Commission's rules and submitted with the Postal Service's original filing.

The Postal Service and the other participants in this docket have already spent four months considering the proposals embodied in the Postal Service's Request and testimony. Creating a new base year and rolling it forward would essentially place many of the parties back at square one with respect to many aspects of this effort, such as rate policy and rate design. While adjusting the schedule would likely not require an equal period of time, it might be expected that at least one additional month after new test year estimates become available might be required for an adequate opportunity to

scrutinize these estimates. Such an opportunity might be necessary to enable parties to explore and test whether information already placed on the record with respect to the Postal Service's original filing is still relevant and reliable.

Perhaps the most fundamental consequences of these changes relate to the Postal Service's case and its own due process rights. Requiring the creation of a new base year would, in effect, comprehensively supplant the Postal Service's original filing and nullify much of its testimony and its specific rate and fee proposals. New base year data and test year estimates could confront the Postal Service with the unattractive prospect of withdrawing its Request and seeking approval from the Board of Governors of new rate and fee proposals. The consequent delay in implementing new rates would result in a loss of hundreds of millions of dollars. Alternatively, the Postal Service could continue to maintain its original proposals and seek to provide new evidence justifying those changes in light of revised test year estimates. This course could lead to additional pressure on the Commission's ability to deliver recommendations within the original ten months.

In light of these effects on the schedule and on due process, the suggestion that the FY 1998 base year might be replaced is questionable. The parties' due process opportunities would be squeezed between the necessary revisions, which would take several months, and the Commission's obligation to recommend new rates within ten months. The Commission's ability to evaluate the record and develop an Opinion and Recommended Decision, furthermore, could be seriously impaired. The existing schedule, with no further delay, affords only a little over two months for Commission deliberations. Significantly less time would substantially affect the quality of the

recommended decision and the Postal Service's ability to defend it, if it is approved by the Governors and challenged in court.


Substantive effects

As noted above, it is impossible to predict precisely the effects on individual mail classifications and special services of rolling forward a new base year. A comparison of Postal Service estimates for FY 1999 with the FY 1999 CRA results, however, does not impel creation of a FY 1999 base year. As indicated in the comparisons in Attachment 1 of NOI 2, the variances of unit costs under either the Postal Service's or the Commission's costing approaches are generally small. To the extent that the variances for particular subclasses are deemed substantial enough to warrant separate consideration, it may be possible to take such information into account without running a complete roll-forward based on FY 1999. Any such adjustment, however, could only be done on the record with full due process rights afforded to affected parties.

Respectfully submitted,

UNITED STATES POSTAL SERVICE

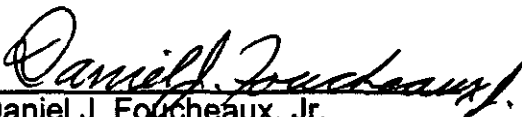
By its attorney:


Daniel J. Foucheaux, Jr.

475 L'Enfant Plaza West, S.W.
Washington, D.C. 20260-1137
(202) 268-2989, Fax -5402
May 8, 2000

CERTIFICATE OF SERVICE

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


Daniel J. Fouchaux, Jr.

475 L'Enfant Plaza West, S.W.
Washington, D.C. 20260-1137
(202) 268-2989, Fax -5402
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