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POSTAL RATE COMMISSION
OFFICE OF THE SECRETARY

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

Postal Rate and Fee Changes, 2000) Docket No. R2000-1

ANSWERS OF THE OFFICE OF THE CONSUMER ADVOCATE
TO INTERROGATORIES OF UNITED STATES POSTAL SERVICE
WITNESS: EDWIN A. ROSENBERG (USPS/OCA-T3-1-17)
(June 23, 2000)

The Office of the Consumer Advocate hereby submits the answers of Edwin A. Rosenberg to interrogatories USPS/OCA-T3-1-17, dated June 9, 2000. Each interrogatory is stated verbatim and is followed by the response.

Respectfully submitted,

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USPS/OCA-T3-1. Please refer to page 8, line 3, of your testimony where you state:

> At the present time, the United States is operating in a climate of relatively low inflation, and the Federal Reserve Board, under Chairman Alan Greenspan, is committed to hold inflation at moderate levels. Indeed, recent increases in the target federal funds rate are pre-emptive strikes against nascent inflationary pressures.

(a) Please confirm that increases in the federal funds rate are intended to slow economic growth. If you do not confirm, please explain your answer fully.

(b) Please confirm that Postal Service mail volume and revenue could be adversely affected as a result of slower economic growth. If you do not confirm, please explain your answer fully.

RESPONSE TO USPS/OCA-T3-1:

(a) Confirmed. The intended result of the increases in the federal funds rate is to slow the economy's rate of growth to a sustainable level, thereby reducing potential inflationary pressure.

(b) To the extent that the rates of growth of mail volume and revenue are positively related to the rate of growth of economic activity, rates of growth of mail volumes and revenue will slow as the rate of growth of economic activity slows. However, whether this can be characterized as "adverse" depends on whether the slower rate of economic growth is less than the assumed rate of growth built into the Postal Service's volume and revenue projections.

In addition, because of variable or volume-sensitive components of cost, slower growth of mail volume is also likely to result in slower growth of total cost. Finally, slower economic growth may result in a lower rate of inflation than would be the case if economic growth were more rapid, and lower inflation also tends to reduce upward pressure on Postal Service costs.

USPS/OCA-T3-2. Please refer to page 11, line 8, of your testimony, where you state:

> "Nothing in the recent operating history of the Postal Service suggests that the 2.5 percent request is necessary."

(a) Do you consider yourself an expert on recent and historical Postal Service operations? If your answer is yes, please explain what experience and/or information has enabled you to become an expert.

(b) How long have you been studying Postal Service operations?

RESPONSE TO USPS/OCA-T3-2:

(a) and (b) I have not offered testimony about Postal Service operations. The section of my testimony from which the quote is taken discusses the recent financial success of the Postal Service. I testified that the Postal Service has operated successfully (in terms of financial results) with a contingency provision less than the 2.5 percent it has requested in this Docket. That statement was based on the Postal Service's positive net income figures for each year in the 1995 through 2000 period as shown in USPS Exhibit 9L. During that period Postal Service operations generated a cumulative net income of $5.58 billion. Furthermore, since the contingency provision was set at two percent in Docket No. R94-1 and at one percent in Docket No. R97- 1, the Postal Service was able to achieve those financial results while operating with a contingency provision lower than the 2.5 percent requested in this case.

USPS/OCA-T3-3. Please refer to page 11, line 10, of your testimony, where you state:

> Unlike some situations that the Postal Service has experienced historically, there is no chronic or growing deficit resulting from an over forecast of revenues and/or under forecast of expenses. As shown in Mr. Tayman's Exhibit 9L, the Postal Service has achieved a positive net income in every year since 1995 and is projected to do so during FY 2000.

Please confirm that net income has declined in every year during the period in question from $1.8 billion in FY 95 to less than $100 million projected for FY 2000. If you do not confirm, please explain why.

RESPONSE TO USPS/OCA-T3-3:

As shown in USPS Exhibit 9L, net income has declined over the FY 1995 to FY 2000 period. Note, however, that the Postal Service has earned a positive net income in each of those years, so it was able to meet its breakeven goal. In fact, during that period the Postal Service generated a cumulative net income of $5.58 billion.

Moreover, part of the decline may be related to the Postal Rate Commission's R97-1 decision, which reduced the provision for recovery of prior years' losses and the contingency provision from the levels approved in R94-1. As shown in Appendix A of the R94-1 Opinion, the Commission recommended a contingency provision of $1.050607 billion and an allowance for recovery of prior years' losses of $936.226 million for a total of $1.986833 billion. As shown in Volume 2, Appendix C of the R97-1 Opinion, the Commission recommended a contingency provision of $598.956 million and an allowance for recovery of prior years' losses of $377.063 million for a total of $976.019 million. Other things being equal, those changes would reduce net income by $1.010814 billion per year.

The trend is not necessarily continuing or worsening. The Postal Service reported net losses in FY 2000 Accounting Periods 5, 6, and 9, but it had net incomes in Accounting Periods 1, 2, 3, 4, 7, and 8. The Accounting Period 9 loss put year-to-date net income ($906.5 million) behind the net income for the same period of FY 1999 ($1.0625 billion). However, year-to-date net income through FY 2000 Accounting Period 8 ($1.0695 billion) was ahead of net income for the same period of FY 1999 ($1.033 billion). Moreover, for five of the first nine Accounting Periods of FY 2000, reported net income was higher than it was in the same periods of FY 1999.

USPS/OCA-T3-4. Please refer to page 11, line 15, of your testimony, where you state:

> In fact, during the 1995 through 2000 period, the Postal Service generated a cumulative net income of $5.58 billion. The contingency provision was set at two percent in Docket No. R94-1 and at one percent in Docket No. R97-1. In each year since implementation of the rates approved in R94-1, the Postal Service has operated quite successfully with a contingency provision less than the 2.5 percent it has requested in this Docket.

(a) Please confirm that the period covered by these results was covered by the contingency levels determined by Postal management to be necessary (i.e., the contingency amounts reflected in the rates that were in effect during this period were not adjusted by the Commission). If you do not confirm, please explain and provide your sources.

(b) Would you say that actual results during this period indicate that Postal management's judgment related to the selection of the contingency in Dockets R94-1 and R97-1 amounts was good? Please explain any negative answer fully.

RESPONSE TO USPS/OCA-T3-4:

(a) In R94-1, the contingency provision was set at two percent of estimated costs. In R97-1, the contingency provision was set at one percent. Those were the amounts requested. However, in R97-1, Postal Service witness Porras testified that, if the Commission reduced the revenue requirement by using updated (lower) actual cost figures rather than the original estimates of costs, the contingency should be set at 1.5 percent rather than the one percent originally requested. The Commission rejected that suggestion in its Opinion and Recommended Decision.

(b) In his testimony in R94-1, Postal Service witness Ward expressed concern that the two percent contingency might provide a smaller margin than would normally be prudent. That concern proved to be overstated, since the Postal Service was able to meet its breakeven goal during each year the R94-1 rates were in effect, generating over $5 billion in net income during the period from 1995 to 1998.

In his testimony in R97-1, Postal Service witness Tayman argued that the one-percent contingency request was based on the Postal Service's financial success, the favorable economic climate, and management's concern about the effect of the contingency on rate levels. Moreover, the one-percent contingency requested in that case has proved to be sufficient, since the Postal Service has generated positive net income since the R97-1 rates went into effect.

Postal Service management's judgment and concern for the effect of the contingency on rate levels in R97-1 are commendable. Although Mr. Tayman testified in R97-1 that the Postal Service was leaving the door open to a larger contingency if circumstances were to change, it is not clear from his testimony in this case what circumstances have changed to alter management's judgment, reduce their concern about the effect of the contingency on rates, and necessitate a one hundred fifty percent increase in the requested contingency provision (from one percent to 2.5 percent), especially given the history of successful operation with lower contingency levels.

USPS/OCA-T3-5. Please refer to page 8, lines 17-20, of your testimony, where you state:

> A disciplined analysis of the optimum size of a contingency provision would consider the following factors:
> 1) The magnitude and types of uncertainties that necessitate the existence of a contingency provision. Of particular concern in this regard is the state of the economy.
> 2) The historical experience of the Postal Service with respect to its contingency provision. How has the Postal Service fared under various provisions?
> 3) The short-run and long run effects of the contingency provision turning out to be either too large or too small.
> a) On the Postal Service and its managers
> b) On the customers of the Postal Service

(a) Please confirm that one of the factors which should be considered in determining the size of the contingency, which you have not included on your list, is the adverse impact of future events that are totally unknown. If you do not confirm, please explain fully why you believe the contingency is not intended to protect against totally unknown adverse events.

(b) How does one determine the magnitude of totally unknown events? Please explain you answer.

RESPONSE TO USPS/OCA-T3-5:

(a) In my use of the term "uncertainties," I include the impact of both forecasting errors and future events that are totally unknown.

(b) One cannot determine the magnitude of totally unknown events. However, one can do hypothetical scenario analyses and attempt to estimate the impact of events that are unknown but conceivable. Some catastrophic or cataclysmic events (a large meteor hitting earth, nuclear war, for example) would have a huge impact, but they have a low probability of occurring. Other events (a recession or an oil embargo, for example) could have a large impact and a have higher probability of occurring than the catastrophes mentioned earlier. The contingency provision is intended to provide a buffer for adverse events, but some unknown events could have beneficial effects (collapse of the oil cartel, a significant technological breakthrough, for example).

Although it is extremely difficult, if not impossible, to forecast the occurrence of such events, it is possible to develop scenario analyses for adverse events and attempt, however imperfectly, to estimate their impact and have contingency plans in place for dealing with them. Admittedly, the further outside the range of historic experience an event is, the more difficult it is to estimate its impact and develop a plan for reacting. Random events do, however, occur from time to time, and the ability of the Postal Service to react to and survive various events is reflected in its record of successful operation. Moreover, although the contingency provision is intended to provide a buffer against uncontrollable or unknowable adverse events, it need not be large enough to provide a buffer against all unknowable adverse events.

USPS/OCA-T3-6. Please refer to Chapter IV C. in your testimony entitled "The Postal Service's Ability to Forecast is Improving." In your opinion, has the Postal Service's ability to forecast improved? Please reconcile any negative answer to the above citation.

RESPONSE TO USPS/OCA-T3-6:

The section of my testimony referenced above lists several reasons why I believe that the Postal Service's ability to forecast has improved when compared with earlier periods. My reasons include the Postal Service's nearly thirty years operating in a business-like manner, inflation rates that are both relatively low and less volatile than they were in the 1970s and 1980s, and the creation of a forecasting organization with the purpose of creating more accurate and reliable forecasts. For all these reasons, I believe that the Postal Service's ability to forecast has improved compared with some earlier periods.

USPS/OCA-T3-7.

(a) Please refer to page 2 of the A/P 8 Financial and Operating Statements (FOS) and confirm that the Postal Service is currently $333.1 million below its planned net income through A/P 8 PFY 2000. If you do not confirm, please explain fully.

(b) Please also refer to the FOS for A/P 9 (which will be released before the due date for this question) and confirm the Postal Service incurred a loss of $154 million in A/P 9 and the year-to-date plan shortfall grew to $420.4.

(c) Please confirm that, even if the Postal Service can reverse this trend of below-plan results and achieve its plan for the remainder of the year, it will suffer a plan shortfall and incur a loss for FY 00, instead of the planned net income of $100 million reflected in the response to ANM/USPS-T9-41.

RESPONSE TO USPS/OCA-T3-7:

(a) I confirm that for year-to-date through FY 2000 Accounting Period 8 the Postal Service reported that its net income was $333.1 million below plan. I note, however, that for the same period of PFY 1999, the Postal Service was $342.1 million below plan, yet, as shown in USPS Exhibit 9L, it was able to generate $363.4 million in net income for 1999. This income figure was greater than the $200 million planned for 1999 as shown in the response to ANM/USPS-T9-41.

(b) I confirm that the Postal Service reported a net loss of $154.2 million for FY 2000 Accounting Period 9 and that the Postal Service reported that its year-to-date net income through FY 2000 Accounting Period 9 was $420.4 million below its plan. As I noted in my answer to USPS/OCA-T3-3, the Postal Service reported net losses in FY 2000 Accounting Periods 5, 6, and 9 and net incomes in Accounting Periods 1, 2, 3, 4, 7, and 8.

(c) According to the U.S. Postal Service FY 2000 Operating Plan (filed in response to OCA/USPS-T9-27 and OCA/USPS-81), the Postal Service plans to incur losses of $217.5 million, $237.5 million, $281 million, and $348 million in FY 2000

Accounting Periods 10, 11, 12, and 13, respectively. Thus, if the Postal Service operates according to its plan, the total loss for the remainder of FY 2000 will be $1.084 billion. If net losses for the rest of FY 2000 run according to the plan, the Postal Service will incur a net loss of $177.5 million for FY 2000, given reported year-to-date net income of $906.5 million through FY 2000 Accounting Period 9. The response to ANM/USPS-T-9-41 indicates that the Postal Service's FY 2000 plan was for net income to be $100 million.

However, the scenario just described may not come to pass. It is typical for the Postal Service to report net losses in Accounting Periods 10 through 13, and Postal Service plans for FY 1999 and FY 2000 reflect that tendency. In FY 1999, the Postal Service did, in fact, report net losses in each of Accounting Periods 10 through 13, but the actual net loss in each period was less than the net loss assumed in the Postal Service's FY 1999 plan. This is illustrated at page 4 of the Postal Service's Financial and Operating Statements for Accounting Period 13, PFY 1999. It is possible that the Postal Service's FY 2000 plan for Accounting Periods 10 through 13 may also prove to be overly pessimistic. I note that the actual results in FY 2000 Accounting Periods 1, 2, 3, 4, and 7 were better than the actual results for the same periods in FY 1999, and actual results in FY 2000 Accounting Periods 1, 4, and 7 were better than the results assumed in the FY 2000 plan. Moreover, I hope that management is taking steps to enhance revenues and control expenses so that a loss will not be realized in FY 2000.

USPS/OCA-T3-8. Please refer to Board of Governors Resolution No. 95-9 (policy statement on equity restoration) and the report on equity restoration prepared by Price Waterhouse LLP for the BOG. (Docket No. MC96-3, LR SSR-112). In your opinion, is the restoration of equity important to the Postal Service and its customers? Please explain any negative answer.

RESPONSE TO USPS/OCA-T3-8:

Restoration of equity by the Postal Service is an important goal that would have benefits for the Postal Service. Restoration of equity does provide benefits for customers, but whether it provides customers with net benefits depends on whether they prefer lower postal rates in the near term or in the longer term. This is because restoring equity requires higher postal rates in the near term. As equity is restored, Postal Service debt and interest expense should decline over time, as should the provision for recovery of prior years' losses, both of which tend to lower rates. Thus, equity recovery requires higher rates near term and provides the benefit of lower rates over the longer term.

Since 1995, when the above referenced Resolution and Price Waterhouse report were prepared, the Postal Service has improved its equity position considerably. At the end of 1994, as shown in USPS Exhibit 9L, the Postal Service had negative equity of $5.96 billion. At the end of 1994, the Postal Service was at its nadir with respect to its equity position and had suffered net losses in eight of the previous ten years. In contrast, it has enjoyed positive net incomes in every year since 1994. The equity deficit that existed at the end of 1994 was created over a number of years, and it would not have been prudent to attempt to correct the equity deficit too quickly. Thus, the provision for recovery of prior years' losses uses a nine-year recovery period, which does not unnecessarily increase rates paid by postal customers in any single year.

As of May 19, 2000, the Postal Service had positive equity of $213 million, as shown in the Postal Service's Financial and Operating Statements for Accounting Period 9 of PFY 2000. Thus, over the past six years, the Postal Service has been able to increase its equity by $6.17 billion, and it has done so while operating with a contingency provision far less than the 2.5 percent requested in this case.

USPS/OCA-T3-9.

(a) Based on your training and experience, how much of a variance between actual results and the Postal Service's test year estimates of revenue and expense could occur for the estimate to be considered accurate? Please explain your answer.

(b) Would you consider a test year estimate that is within 1 percent to be accurate? Why or why not?

(c) Would you consider an estimate that is within 2 percent to be accurate? Why or why not?

RESPONSE TO USPS/OCA-T3-9:

(a), (b), and (c) The Postal Service has a breakeven obligation or goal. Thus, an estimate is sufficiently accurate, if, when combined with the contingency provision and the allowance for recovery of prior years' losses, it allows the Postal Service to meet or exceed that goal. In the present case, estimates of test year revenue and expense would be sufficiently accurate if the combined error is no more than approximately $940 million in an adverse direction (revenue less than estimate, and expense greater than estimate). This assumes a one-percent contingency provision ($672 million) and an allowance for recovery of prior years' losses of $268 million, which together total approximately 1.4% of after rates, test year total cost segments as shown in Table 15 of Mr. Tayman's testimony (USPS T-9, p. 22).

USPS/OCA-T3-10. Please refer to page 15 of your testimony, where you discuss what you refer to as built-in safety nets available to the Postal Service which you say support a contingency lower than 2.5%.

(a) Please confirm that all of the items you have referred to as safety nets were available to the Postal Service in the prior six Dockets R76-1 through R90-1. If you do not confirm, please explain and provide your sources.

(b) Please refer to Table 5 in your testimony and confirm that the contingency of 2.5% currently estimated by the Postal Service is lower than the contingency requested in the six Dockets R76-1 through R90-1. If you do not confirm, please explain.

RESPONSE TO USPS/OCA-T3-10:

(a) Confirmed.

(b) Confirmed. Note that, as shown in Table 5 of my testimony, inflation rates were higher when those cases were heard, and when the rates set in those cases were in effect, than they have been more recently and that the Postal Service has achieved considerable financial success since the R94-1 and R97-1 rates went into effect. The Postal Service experienced net losses in eleven of the seventeen years from 1978 through 1994, when the rates set in Dockets R76-1 through R90-1 were in effect, and it was allowed a contingency provision at or above the 2.5 percent requested in this case. In contrast, the Postal Service has had net profits in each year from 1995 forward when allowed a contingency provision less than the 2.5 percent requested in this case.

USPS/OCA-T3-11. Please confirm that, if all other things are equal, the smaller the contingency the more likely that a test year loss will be incurred. If you do not confirm, please explain how a smaller contingency would not increase the odds of incurring a loss in the test year.

RESPONSE TO USPS/OCA-T3-11:

Other things equal, a smaller contingency provision increases the likelihood that there will be a loss in the test year. Conversely, a larger contingency provision reduces the likelihood of a net loss. However, other things are rarely equal, and the size of the contingency provision is only one factor that determines whether or not the Postal Service will operate at a profit or a loss. The state of the economy, including the rate of inflation and the rate of economic growth, and Postal Service management's actions to control costs and enhance revenue also determine whether a profit or a loss will be realized. Moreover, although a larger contingency provision will generally reduce the likelihood of the Postal Service's incurring a net loss, there may be some point beyond which raising the contingency provision actually decreases the Postal Service's ability to break even.

As noted in my answer to USPS/OCA-T3-10, the Postal Service experienced net losses in eleven of seventeen years (1978 through 1994), during which time it was allowed a contingency provision as large or larger than the one requested in this case. In 1985, 1988, and 1991, the years the R84-1, R87-1, and R90-1 rates went into effect, respectively, the Postal Service reported losses, even though a contingency provision of 3.5 percent was allowed in each of those cases. In contrast, the Postal Service has reported net profits in each of the past six years (1995 through 2000, including projected

2000 results) while operating with a contingency provision smaller than the 2.5 percent requested in this case.

USPS/OCA-T3-12. Please refer to page 16 of your testimony, where Section F is entitled: "Many Potential Sources of Expense and Revenue Variation are Accounted for In the Estimated Revenues and Expenses."

(a) Please confirm that you are referring to estimates of changes in revenue and expense based on events that are assumed to occur, such as wage increases and the price of fuel. If you do not confirm, please explain fully.

(b) Please confirm that estimates similar in nature were reflected in all previous rate filings. If you do not confirm, please explain fully.

(c) Please confirm that there is uncertainty regarding the actual outcome of these events (e.g., the labor contract may be more costly than estimated and the price of fuel may be higher than estimated) and that this type of uncertainty is not accounted in the Postal Service's estimates of revenues and expenses other than through the contingency. If you do not confirm, please explain fully.

RESPONSE TO USPS/OCA-T3-12:

(a) Confirmed. I also assume that the after-rates test year estimates include projections of inflation, economic growth, and the effect of changes in postal rates on volume, revenues, and expenses.

(b) Confirmed. However, as I note at page 12, lines 8 through 20, of my testimony, some of those estimates were made during periods when the rate of inflation was both higher and more volatile than it has been recently or than it is projected to be in the near-term future. The relatively stable economic climate we are enjoying at the present time allows greater confidence in the accuracy and reliability of the estimates and allows a smaller contingency provision than would be the case in more volatile periods.

(c) Various items could turn out to be higher or lower than the estimates built into the after-rates, test year revenue and expense figures. In the four previous cases (R87-1, R90-1, R94-1, and R97-1), the Postal Service's revenue estimates were too high twice and too low twice, and its expense estimates were too high once and too low three times. Note that the test year will be in progress by the time the Commission issues its decision, so some expense and revenue elements may be less uncertain at that time than they were when the original estimates were developed. Furthermore, in addition to the contingency provision, management's ability and duty to control cost and enhance revenue is an important factor in determining whether the bottom-line results are positive or negative.

USPS/OCA-T3-13. Please refer to page 18, lines 14 -18, where you state:

> "This appears to be an attempt for the Postal Service to have their cake and eat it too: recognizing that their ex ante forecasts may turn out to be wrong ex post – leading to the necessity for the provision for contingencies – but asserting their ability to accurately gauge the amount by which their forecasts are likely to be wrong."

Please provide the basis (including sources) of your statement that the Postal Service asserts that it can "accurately gauge the amount by which their forecasts are likely to be wrong."

RESPONSE TO USPS/OCA-T3-13:

In each case, the Postal Service requests a contingency provision that reflects management's judgment concerning the size of the contingency they feel necessary to provide an adequate cushion against the effects of unforeseen, unexpected, and uncontrollable adverse events that are not reflected in the test-year estimates. I have made the inference that the size of the contingency request is based on Postal Service management's judgment as to the accuracy and reliability of their forecasts or estimates of test-year revenue and expense and the degree of uncertainty they face.

In R94-1, the Postal Service requested and was allowed a two-percent contingency. In R97-1 the Postal Service requested and was allowed a one-percent contingency. Those contingency amounts proved to be adequate as evidenced in the fact that the Postal Service has generated over $5 billion in net income since 1994. In this case, the Postal Service has requested a one hundred fifty percent increase in the allowed contingency provision (from one percent to 2.5 percent). From this I infer that Postal Service management believes that its estimates for the 2000 test year are likely to be less accurate than the estimates for the two prior years proved to be. I also infer that the size of the increase in the contingency request reflects the amount by which they believe their forecasts or estimates may be in error.

USPS/OCA-T3-14. Please refer to page 20, line 16, of your testimony, where you state that "electric utilities attempt to keep a reasonable amount of reserve capacity available so that consumers are not faced with power brownouts or blackouts during extreme weather - and consumers pay for the maintenance of this reserve capacity."

(a) What percent of reserve capacity is typically kept by electric utilities?

(b) What is the maximum amount of reserve capacity kept by a utility of which you are aware and what is the minimum? Please provide the source of your answer.

RESPONSE TO USPS/OCA-T3-14:

(a) Given the changes taking place in the electric utility industry, I'm not sure that there is a "typical" reserve margin anymore. The electric utility industry has begun to rely on regional interconnection, wholesale transactions between utilities, power purchased from independent power producers and non-utility generators, and interruptible power contracts to meet or control peak loads.

For the investor-owned electric utility industry as a whole, the approximate capacity margin (the percent of capacity not needed at peak load) was 14.9 percent in 1996 and 13.4 percent in 1997. I calculated these figures from electric utility industry data in *The Value Line Investment Survey, Edition 1*, March 10, 2000, p. 156.

Capacity margins are also published on a regional basis. In part, this recognizes the robust wholesale market now taking place in electricity. It also recognizes the interconnected nature of the electric utility industry.

Here are the summer 1999 capacity margins for the various U.S. regions (Figures from the North American Electric Reliability Council's *Reliability Assessment 1999-2008*, March 2000, p. 14.]:

ECAR (East Central Area Coordination Agreement), 12.5%;

ERCOT (Electricity Reliability Council of Texas), 15.9%;

FRCC (Florida Reliability Coordinating Council), 13.0%;

MAAC (Mid-Atlantic Area Council), 14.2%;

MAIN (Mid-America Interconnected Network), 13.6%;

MAPP-US (Mid-Continent Area Power Pool -- U.S.), 14.4%;

NPCC-U.S. (Northeast Power Coordinating Council — US), 14.4%;

SERC (Southeastern Electric Reliability Council), 12.8%;

SPP (Southwest Power Pool), 14.5%;

WSCC--U.S. (Western Systems Coordinating Council -- US), 17.5%;

Overall United States, 14.3%.

(b) There may be utilities with reserve or capacity margins as high as 40 percent, or more. Those utilities rely on sales to other utilities to absorb their excess capacity. Other utilities have negative reserve or capacity margins, meaning that they do not own sufficient generating capacity to serve their customers' peak loads. Those utilities rely on power purchased in the wholesale market to meet their customers' needs.

My discussion of capacity or reserve margins in the electric utility industry was in no way predicated on a belief that the Postal Service requires a contingency reserve of similar magnitude. Rather, I discussed loss of load probability models and Monte Carlo analyses as examples of analytical processes and state (at page 22, lines 2 through 4, of my testimony) that it would be useful for the Postal Service to develop some form of more analytical approach to determining the likely range of outcomes and assigning some likelihood or probability weights to them. I believe the application of such techniques would provide a more objective basis for determining the adequacy of a contingency provision than the judgmental, subjective, and intuitive approach currently taken by Postal Service management.

USPS/OCA-T3-15.

(a) Have you studied the economic and other adverse consequences to the Postal Service and its customers that would result from the Postal Service incurring a loss in the test year? If so, please provide the results. If not please explain why.

(b) Please confirm that a test year loss would have adverse consequences for both the Postal Service and its customers. If you do not confirm, please explain why.

RESPONSE TO USPS/OCA-T3-15:

(a) and (b) This is discussed at page 26, lines 17 through 22, of my testimony. If the Postal Service incurs a loss in the test year, the future path of postal rates would tend to be raised. This is so because the allowance for recovery of prior years' losses would increase in future rate cases, as would interest expense on funds borrowed as a result of the loss incurred. A loss in the test year may result in the Postal Service filing its next rate case sooner than otherwise planned, and it is possible that the specter of a test-year loss could result in some degradation of service levels, depending on the specific actions taken by management to control costs and enhance revenues. To the extent that a loss results from postal rates being set too low for the Postal Service to meet its breakeven goal given honest, efficient, and economical management, postal customers enjoy lower current rates and experience higher future rates.

These are potential costs or adverse effects that must be considered. Nevertheless, these potential adverse effects must be weighed against the adverse effects in terms of the very real opportunity cost or value postal customers place on the consumption, savings, and investment they have to forego to provide an extra $1 billion to fund a contingency provision that is excessive in light of current economic conditions and the recent success of the Postal Service operating under a contingency provision far smaller than that requested in this case. I discuss the opportunity cost of money used to fund used an increase in the contingency provision at page 24, lines 5 through 11, of my testimony.

USPS/OCA-T3-16. Please refer to page 26, line 19, of your testimony, where you begin to state:

> "Admittedly, rate cases take time to file and for new rates to become effective. However, even if it prefers not to do so, the Postal Service has the ability to borrow from the Federal Financing Bank. Such borrowing is generally on advantageous terms, since no private borrower can borrow on terms equivalent to the U.S. Treasury's cost of money plus 1/8 percent."

(a) Are you advocating that the Postal Service borrow money to fund losses instead of raising rates? Please explain your answer.

(b) If the Postal Service were to borrow to fund operations, please confirm that ratepayers will ultimately pay for the additional interest cost of borrowing. If you do not confirm, please explain who will bear this cost and explain fully.

RESPONSE TO USPS/OCA-T3-16:

(a) I have not advocated that the Postal Service borrow to fund losses rather than raise rates. At page 15, lines 8 through 19, of my testimony, I discuss the Postal Service's ability to borrow through the Federal Financing Bank, if it becomes necessary to do so, as being one of several safety nets provided to ensure the viability of the Postal Service.

(b) Borrowing by the Postal Service, whether for operations or for capital investment, results in interest costs that become part of total recoverable expenses. Thus, increased borrowing tends to raise future expenses and future rates. Postal customers will bear this cost. However, the possible cost resulting from borrowing, should the Postal Service operate at a loss, must be weighed against the definite opportunity cost in terms of the value of consumption, savings, and investment forgone by postal customers, if they are asked to fund a contingency provision that is larger than necessary. That opportunity cost is discussed at page 24, lines 5 through 11, of my testimony.

Moreover, I would note that debt is commonly used by utilities, including those that are not investor-owned, as a normal component of their capital structures. Moreover, at September 30, 1999, the Postal Service's long-term debt of $3.544 billion was only 6.36 percent of total liabilities and equity, and total debt (including the current portion of long-term debt) was $6.92 billion or 12.4 percent of total liabilities and equity. Furthermore, the Postal Service's use of debt has been decreasing. As of May 19, 2000, long-term debt had declined to $2.553 billion, or 4.41 percent of total liabilities and equity, and total debt (including the current portion of long-term debt) stood at $4.492 billion or 7.77 percent of total liabilities and equity.

USPS/OCA-T3-17. Please refer to page 28, lines 7-12, of your testimony, where you state:

> the contingency provision should not be used as a substitute mechanism for recovery of prior years' losses. It would not be proper to use the contingency provision, even implicitly, as a mechanism of equity restoration. If the Postal Service wants to accelerate its rate of equity recovery, it can request a shorter amortization period for recovery of prior years' losses rather than using a back-door approach.

Is it your testimony that the Postal Service selected a 2.5% contingency in this case in order to restore equity? If your answer is yes, please provide all evidence supporting this allegation.

RESPONSE TO USPS/OCA-T3-17:

If the Postal Service is allowed to include a larger contingency provision in its revenue requirement, net income will be larger than if it is allowed a smaller contingency provision. Thus, an implicit effect of a larger contingency provision is to accelerate the Postal Service's rate of equity restoration. I am not in a position to know whether Postal Service management chose to request a larger contingency provision with the intent of accelerating the rate of equity restoration. Nevertheless, if the requested increase in the contingency provision is allowed, all other things being equal, the effect will be to accelerate equity restoration.

DECLARATION

I, Edwin A. Rosenberg, declare under penalty of perjury that the answers to interrogatories USPS/OCA-T3-1-17 of the United States Postal Service are true and correct, to the best of my knowledge, information and belief.

Executed 21 June 2000

Edwin A. Rosenberg

CERTIFICATE OF SERVICE

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

Shelley S. Dreifuss

Shelley S. Dreifuss

Washington, DC 20268-0001
June 23, 2000