

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

MOTION OF THE UNITED STATES POSTAL SERVICE FOR
CLARIFICATION OR RECONSIDERATION OF PRESIDING OFFICER'S
INFORMATION REQUEST NO. 18
(August 1, 2000)

The United States Postal Service hereby requests clarification or reconsideration of Presiding Officer's Information Request (POIR) No. 18, issued on July 28th. POIR No. 18 consists essentially of a follow-up to the Postal Service's July 27th response to POIR No. 16. In general, these two POIRs involve the matter of updated revenue projections to correspond to the updated cost projections submitted in response to Order No. 1294.

Background

In POIR No. 16, the following information was sought:

To ensure that the record contains consistent information allowing all parties to make a meaningful evaluation of cost coverages, the Service is requested to provide revenue estimates by subclass and service that reflect FY 1999 billing determinants in the manner it deems appropriate.

FY 1999 was a year in which two distinct rate regimes were in place. Prior to January 10, 1999, a date which fell within postal quarter 2 of that year, the rates in effect were primarily those coming out of the mail classification reform cases, Docket Nos. MC95-1 and MC96-2. For purposes of simplicity, those rates can be referred to as the "pre-R97" rates, because the rates in effect on January 10, 1999 and thereafter were the rates established pursuant to Docket No. R97-1, or the "post-R97" rates.

In the context of billing determinants, at least two types of complications can be created by changes in rate regimes. One type of complication arises when relative prices change, and mailers shift the manner (and categories) in which they enter mail in response to changing price signals. A second type of complication arises when classification changes accompany the new rate regime, so that even if mailers are entering the exact same types of mail prepared in the exact same fashion, that mail pays postage and gets recorded in a different category than it would have under the previous rate regime. Therefore, when rate regimes change in the middle of the year, as they did in FY 1999, complications in the preparation of billing determinants are inevitable.

Even more inevitable under such circumstances are complications in the *application* of billing determinants for use in forecasting revenues for a period subsequent to the historical year of their origin. These complications arise because the mail piece characteristics reflected in the billing determinants are not necessarily constant throughout any given year. Therefore, when rate regimes change in the middle of a year, billing determinants for the two portions of the year representing each of the rate regimes may be different because of factors such as the two examples discussed above, or may be different because of seasonality.

In this proceeding, the Postal Service has provided FY 1999 billing determinants for the entire year in the aggregate, and separately for the pre-97 and the post-97 regimes. These are found in LR-I-259, and have been available since between late March and early May. Every rate case participant has had the opportunity since then to utilize the FY 1999 billing determinants for whatever purposes desired, including

deriving their own updated estimates of test year revenues in the manner they deemed most appropriate.

As quoted above, POIR No.16 requested that the Postal Service "provide revenue estimates by subclass and service that reflect FY 1999 billing determinants in the manner it deems appropriate." The Postal Service carefully considered this request, in light of all of the types of complications discussed above, and with the belief that the desired result was the best possible forecast of test year revenues. It is clear that the pre-R97 billing determinants from FY 1999 do not reflect the changes precipitated by the change in rate regimes on January 10, 1999. It is likewise clear that, because the full year billing determinants include the pre-R97 information as well, the full year data likewise fail to reflect those changes. (As an obvious example, the full year FY 1999 billing determinants include data for Standard A single piece, when, because of the R97 changes, that category no longer exists.) Only in the post-R97 portion of the year did the opportunity exist to have the effects of those changes fully reflected. Unfortunately, however, the post-R97 FY 1999 information relates to only a portion of the year, and therefore also reflects the potential effects of seasonality as well. The Postal Service is unaware of any methodology which, when limited to FY 1999 data, allows the effects of the R97-1 rate and classification changes to be disentangled from the effects of seasonality in a manner that is likely to meet all concerns.

In response to POIR No. 16, the Postal Service determined that the best way to avoid all of these complications was to develop billing determinants for the four-quarter period from FY99Q3 through FY00Q2. This period fully reflected the R97 changes,

avoided concerns of seasonality, and retained as much of the FY 1999 information as possible. (It conceivably may have been feasible to utilize a four-quarter period from FY99Q4 through FY00Q3, but that would have excluded an additional quarter, Postal Quarter 3, of FY 1999 information.) The Postal Service considered its POIR No. 16 approach to be fully and directly responsive to the Presiding Officer's request to "provide revenue estimates by subclass and service that reflect FY 1999 billing determinants *in the manner it deems appropriate.*" (Emphasis added.)

Witness Mayes' response to POIR No.16 was filed on July 27th. On July 28th, POIR No.18 was issued. In considering the updated test year cost forecasts provided by the Postal Service in response to Order No. 1294, and the updated test year revenue forecasts provided in response to POIR No.16, POIR No.18 stated:

There is a misalignment in the cost coverages provided in the Responses in that the costs relate to the mail sent in FY 1999, and the revenues reflect the "hybrid billing determinants" of the mail sent in the last half of FY 1999 and the first half of FY 2000. Furthermore, it does not appear that the Postal Service considered the alternative of using the post-implementation period of FY 1999 to adjust the pre-implementation period, much as the Postal Service's original filing used, in many cases, parts of the post-implementation period to adjust the billing determinants from FY 1998.

On that basis, POIR No. 18 concluded:

1. The Postal Service is to answer the original information request, using FY 1999 billing determinants, adjusted as it deems appropriate through the use of the post-implementation period data, in the manner that FY 1998 billing determinants were adjusted in the original filing.
2. The Postal Service is requested to provide a comparison of the advantages and disadvantages of using 1999 billing determinants adjusted in this fashion, as opposed to using "hybrid billing determinants."

POIR No. 18 (July 28, 2000) at 2.

Discussion

Initially, it may be noted that with respect to the cost coverages provided in response to POIR No. 16, neither the costs nor the revenues relate to either the mail sent in FY 1999, or the mail sent in the hybrid four quarters of FY99Q3-FY00Q2, as the above language of POIR No. 18 might be read to suggest. Instead, in each instance, they relate to what has been forecasted for the test year 2001. If cost coverages had been calculated based on costs and revenues from different historical time periods, the stated concern would be well founded. Instead, in this instance, the cost coverages result from forecasts of costs and revenues for the same prospective time period, merely developed using (in some respects) slightly different base periods.

There is nothing unique about this situation. In several prior rate cases (e.g., R97-1, R87-1), the base years employed for cost forecasting and for volume (and hence revenue) forecasting have been different. This has resulted from the desire to use the best information available, and the ability of the volume forecast methodology to incorporate results quarter-by-quarter, whereas the cost forecast works best with a base period of an actual fiscal year. In any event, given the language of POIR No. 18, it perhaps merits explicit mention that, in fact, there is no misalignment of the time period of the cost and revenue forecasts themselves.

The intended focus of the POIR, therefore, must be on the base period employed for the forecasts. To the extent that the POIR expresses concerns with a potential misalignment, its concerns are relevant only in that much more limited context. It is important, however, to examine the exact nature of the alleged misalignment. The POIR speaks of the costs relating to the mail sent in FY 1999. When the entire

historical fiscal year is used as the cost base, it is true that the aggregate costs necessarily reflect the characteristics of all of the mail actually sent in FY 1999. The only set of billing determinants which likewise reflects the characteristics of all of the mail actually sent in FY 1999, however, is that set which includes all of FY 1999 in one aggregate package.

Even POIR No.18 appears to appreciate the fact that this set of billing determinants (i.e., unadjusted total FY 1999) will not resolve its concerns. In the very next sentence after the one in which the specter of misalignment is raised, the POIR proceeds to discuss the potential for adjustments -- “using the post-implementation period of FY 1999 to adjust the pre-implementation period.” The introduction of *any* adjustments, however, will necessarily result in a misalignment of the type apparently sought to be avoided by POIR No. 18. The cost base would still be the costs caused by the actual characteristics of the mail entered in FY 1999, while an adjusted set of billing determinants would reflect something other than the actual characteristics of that mail. In terms of creating a potential misalignment, it is irrelevant whether the pre-implementation period is adjusted on the basis of post-implementation FY 1999 data, or (in effect) on the basis of post-implementation FY 2000 data. Either type of adjustment is incongruous with the objective of complete harmony between the forecast base for costs and revenues.

Perhaps more fundamentally, such an objective is not realistic under any circumstances. Factors which will change the postal environment over time are myriad. Forecasting costs is never so simple as to assume a static postal world that allows purely mechanical roll-forward from an historical base period to an identical prospective

test year. Forecasting revenues is never so simple as to assume that nothing will happen between the base period and the test year to affect how mail is created, prepared, entered, and rated. Given the profound lack of congruity between factors which will affect costs and factors which will affect revenues, the most rational approach is to focus on doing the best possible job forecasting test year costs, and to focus separately on doing the best possible job in forecasting test year revenues. What is critical is that these estimates intersect appropriately in the test year.¹ The route by which they get there (e.g., which base period is used) is usually of far less importance. To the extent that POIR No.18 appears to focus on attempting to exclude the possibility of any misalignment between the cost and revenue forecasting bases, therefore, it may be predicated on a standard which is fundamentally unrealistic.

Moreover, the Postal Service is unaware of any adjustment of FY 1999 billing determinants which could be based exclusively on FY 1999 data, and yet nonetheless still provide forecasts of test year revenue that are likely to be as accurate as those obtained using the FY99Q3-FY00Q2 hybrid. Whatever disadvantages are caused by using test year cost and revenue forecasts based on different base periods are easily outweighed by the advantages of having substantially improved test year revenue forecasts. Using the hybrid billing determinants avoids many problems that, in the context of exclusive FY 1999 data, could only be addressed by attempting to patch together some type of "adjustments." Given the ability of the hybrid data to circumvent these problems entirely, revenue estimates from the hybrid are likely to constitute

^{1/} Note that the rollforward model incorporates "final adjustments" for many subclasses, permitting additional means by which to more closely align costs with mail mix.

substantial improvements over test year revenue estimates limited to the use of the FY 1999 data, however adjusted. Thus, although the focus of POIR No. 18 appears to be limited to comparing cost coverages, revenue forecasts have critical importance in contexts other than cost coverages, and that the overall utility of obtaining the best possible test year revenue forecasts would appear to be beyond cavil.

POIR No.18 speaks of "using the post-implementation period of FY 1999 to adjust the pre-implementation period, much as the Postal Service's original filing used, in many cases, parts of the post-implementation period to adjust the billing determinants from FY 1998." The Postal Service finds this suggestion to be unclear. With respect to the original filing, the adjustments to FY 1998 were to take account of classification changes caused by Docket No. R97-1. Moreover, when starting with a complete set of billing determinants from FY 1998 (a year with no changes in rate regime for the majority of subclasses), issues of seasonality are not evident. This is not to suggest that any adjustments based on post-R97 FY 1999 data (a partial-year period) might not have injected issues of seasonality into the mix, but at least the FY 1998 data covered an entire year. With respect to FY 1999, the circumstances are different. With the change in rate regimes, if pre-R97 data are to be adjusted using post-R97 data, seasonality becomes an issue on both sides of the equation. Unlike FY 1998, there is no block of consistent year-long data with which to work.

Moreover, as discussed above, the Postal Service is concerned that any adjustments it makes in FY 1999 billing determinants would once again raise issues of misalignment. Not only is it unclear exactly what adjustments in FY 1999 billing determinants POIR No. 18 has in mind, but it is even more unclear how those

adjustments could be implemented without creating the exact same problem regarding which POIR No.18 criticized the earlier response to POIR No. 16.

In responding to POIR No. 16, the Postal Service was attempting to be responsive. It was and remains the view of the Postal Service that, if updating is believed to be warranted, the test year revenue forecasts provided in the response to POIR No.16 provide the best available estimates of what revenues by subclass will be in the test year. Nonetheless, POIR No.18 makes clear that the substantial efforts expended in preparing the response to POIR No. 16 were not viewed as satisfactory in achieving what were perceived by some as important objectives of the exercise. As also noted above, the FY 1999 billing determinants have been available, in every possible permutation, since early May. If particular adjustments employing FY 1999 data exclusively were contemplated by these POIRs, given the time constraints under which all participants are operating, it might be more effective in clarifying POIR No. 18 for that information to be shared with all of the parties directly. Even if specific adjustments have not been formulated, in light of the above discussions, the Postal Service believes that more specificity is required in order to avoid a potential repeat of the lack of convergence between the intention of the requestors and the response to the request.

Therefore, the Postal Service respectfully requests that POIR No.18 be reconsidered. To the extent that the discussion in this pleading leads to the conclusion that test year revenue estimates based on the hybrid year are most appropriate, which is the view of the Postal Service, the request could simply be withdrawn. To the extent that is not the case, another type of procedural device (e.g., NOI) might be more

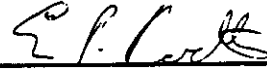
efficiently used to get on the record test year revenue estimates which meet the objectives of the request. In the alternative, if the Postal Service is still to be expected to attempt to provide such estimates, it is respectfully requested that POIR No.18 be clarified in light of the concerns raised in this pleading.

Respectfully submitted,

UNITED STATES POSTAL SERVICE

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Eric P. Koetting

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.



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