
**BEFORE THE
POSTAL RATE COMMISSION**

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POSTAL RATE COMMISSION
OFFICE OF THE SECRETARY

Docket No. R2000-1

POSTAL RATE AND FEE CHANGES, 2000

JOINT REPLY BRIEF

CONCERNING THE REVENUE REQUIREMENT

OF

**THE DIRECT MARKETING ASSOCIATION, INC.
ADVO, INC.**

ALLIANCE OF INDEPENDENT STORE OWNERS AND PROFESSIONALS

ALLIANCE OF NONPROFIT MAILERS

AMAZON.COM, INC.

AMERICAN BUSINESS MEDIA

AMERICAN LIBRARY ASSOCIATION

ASSOCIATION FOR POSTAL COMMERCE

ASSOCIATION OF PRIORITY MAIL USERS, INC.

COALITION OF RELIGIOUS PRESS ASSOCIATIONS

DOW JONES & COMPANY, INC.

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WASHINGTON, D.C. 20268-0001**

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I. INTRODUCTION

The Direct Marketing Association, Inc. (“The DMA”) and the other signatories hereto (referred to collectively as the “Consortium”)¹ respectfully submit this joint reply brief on several important issues relevant to the size of the revenue requirement. As the Consortium demonstrated in its Initial Brief, the Postal Service has overstated its revenue requirement by at least \$1.3 billion. In particular, the Service has: (1) requested a contingency that is unreasonable and not supported by substantial evidence; (2) failed to correct a flaw in the cost reduction estimates generated by the rollforward program for supervision of clerks/mailhandlers and city delivery carriers; and (3) underestimated the cost savings from installing the Advanced Flat Sorting Machine (“AFSM 100”). In the proper exercise of its statutory authority and responsibility, the Commission should reduce the Postal Service’s revenue requirement

¹ The members of the Consortium are The Direct Marketing Association, Inc.; Advo, Inc.; Alliance Of Independent Store Owners And Professionals; Alliance Of Nonprofit Mailers; Amazon.com, Inc.; American Business Media; American Library Association; Association For Postal Commerce; Association Of Priority Mail Users, Inc.; Coalition of Religious Press Associations; Dow Jones & Company, Inc.; Florida Gift Fruit Shippers Association; Magazine Publishers Of America; Major Mailers Association; The McGraw-Hill Companies, Inc.; Parcel Shippers Association; and Time Warner Inc.

accordingly. The adjustments proposed by the Consortium are summarized in the following Table:

TABLE 1
TEST YEAR AFTER RATES
REVENUE REQUIREMENT ADJUSTMENTS

	USPS (\$Thousands)	DMA (\$Thousands)	ADJUSTMENT (\$Thousands)
Contingency	\$1,679,766	\$ 668,978	\$ (1,010,788)
Rollforward Flaw		(92,943)	(92,943)
AFSM 100	169,379	371,510	(202,131)
Total			\$ (1,305,862)

II. THE COMMISSION SHOULD APPROVE A PROVISION FOR CONTINGENCY NO GREATER THAN ONE PERCENT OF TOTAL COSTS.

The Postal Service in its initial brief continues to take the position that the revenue requirement in this case should contain a provision for contingencies equal to 2.5 percent of total Test Year estimated costs. Despite its protestations to the contrary, the USPS Brief serves only to highlight the substantial weaknesses in the Postal Service's case. Therefore, it actually reveals the strength of the arguments made by the Consortium and other participants in this case that the contingency should be substantially lower.²

² See, e.g., ABA+NAPM Br. 27-28; GCA Br. 24-32; OCA Br. 38-70; PSA Br. 40; and VP/CW Br. 75-91.

A. The USPS Brief Acknowledges the Commission's Legal Responsibility to Determine a Reasonable Provision for Contingencies.

The USPS Brief does not repeat the claim made by USPS witness Strasser that a reduction by the Commission in the USPS-requested provision for contingencies would be an “unlawful intrusion into the policy-making domain of the Board.” Tr. 46/20184. Apparently, therefore, the Postal Service has abandoned any such claim. This abandonment is totally appropriate, because, as was demonstrated in the Consortium's Initial Brief, Consortium Br. 3-6, the Commission has both the authority and the responsibility to include in its Recommended Decision a contingency provision that the Commission determines to be reasonable.

The USPS Brief does address some of the legal principles applicable to the PRC's determination of the revenue requirement. The USPS Brief states, quite correctly, that the court in *Newsweek, Inc. v. U.S.P.S.*, 663 F.2d. 1186, (2d Cir. 1981), *aff'd sub nom. National Ass'n of Greeting Card Pubs. v. U.S.P.S.*, 462 U.S. 810 (1983), held that the Commission does not have the authority to play “a ‘disciplinary’ role over the Postal Service.” USPS Br. II-23. The Postal Service brief also points out that the *Newsweek* court “found that ‘nothing in the Postal Reorganization Act empowers the Commission to take act as disciplinarian.’” USPS Br. II-23, *quoting Newsweek*, 663 F.2d at 1204.

The Postal Service completely misses the point, however. The Consortium is not arguing that the Commission should discipline the Postal Service in any way. As the Consortium demonstrated in its initial brief, however, Consortium Br. 3-6, the Commission has both the authority and the responsibility to determine the size of a “reasonable” contingency provision based on the record of each case. The Commission should evaluate and consider carefully all the evidence before it on this subject, including the evidence adduced by Postal Service witnesses and the ultimate judgment of Postal Service management concerning the size of the contingency

provision, in this case, 2.5 percent. However, the Commission should not give any particular deference to Postal Service management's conclusions. It must carefully weigh all the evidence, including the analyses and conclusions presented by other witnesses. Based on a consideration of all the evidence, it should make its own determination as to what is reasonable.³

Although the Postal Service's brief does not argue in so many words that the Commission should defer to Postal Service management concerning the size of the contingency, it does make the (erroneous) statement that "there is no basis for the Commission to substitute its judgment for management's." USPS Br. II-8. Under the Act, it is not a question of the Commission substituting its judgment for that of Postal management, or of anyone else, for that matter. The Commission has the responsibility of making up its own mind on this subject. Yes, it should consider the judgment expressed by Postal Service management. Yes, it should consider the judgments expressed by other witnesses. And it should consider all these judgments in light of all the relevant evidence, of which there is a substantial amount in this record. Based upon all these considerations, the Commission should make its own determination. The concept of the Commission's "substituting" its judgment for that of anyone else reflects a misunderstanding of the Commission's proper role.

³ The Postal Service brief cites a passage from the Commission's opinion in Docket No. R87-1, Vol. I at 35-36, where the Commission discussed the "subjective element" of the contingency determination and stated that "management's determination [is entitled] to a good measure of deference." *See* USPS Br. II-8. Although the meaning of "a good measure of deference" is not further elucidated in the Commission's discussion, the Consortium does not disagree that the Commission should give serious consideration to the subjective views of Postal Service management when exercising its statutory responsibility. The Consortium notes in this respect that the Commission did not state that it should defer to Postal Service management. Moreover, the Commission's R87-1 statement emphasizes the need for the contingency determination to be based upon substantial evidence. The Consortium respectfully submits that regardless of whatever subjective statements may be on this record, the Commission must meld them with the objective, "substantial" evidence of record, which does not support a contingency provision as large as 2.5%.

B. The Notion of a “Customary” Contingency Is Irrelevant and Inappropriate.

The Postal Service Brief spends considerable time discussing the size of the contingencies approved in prior proceedings and the reduction (from a percentage point of view) in the contingencies approved in Docket Nos. R94-1 and R97-1. It then proceeds to argue that the contingency should be returned to “a more customary level.” USPS Br. II-6.

The Postal Service’s point concerning the “customary” character of any particular contingency determination is not particularly clear. The Postal Service does not appear to be arguing, for example, that the contingency determinations made a decade or more ago are entitled to some particular weight or relevance in the context of this record. Any such argument would be erroneous for a number of reasons, including the fact that the determination in each case must be based upon the evidence of record in that case. In other words, if the Commission were to recommend a contingency of 2.5 percent in this case simply because it was “customary,” it would be running a serious risk of committing reversible error and placing its entire recommended decision in substantial legal doubt.

On the other hand, “customary” may simply be USPS shorthand for the notion that, “it was reasonable under the facts of prior cases; therefore, it is reasonable today.” Such a use of the term, which is similar to, but distinct from, the use described in the immediately preceding paragraph, is not quite so fraught with legal error, because it at least implies that an analysis of the current record is required. However, it relies on the proposition that the relevant factors today are substantially unchanged from the relevant factors a decade ago, and it is clear beyond doubt that there have been numerous and important changes in the relevant facts in the interim.

Either way, the Consortium respectfully suggests that it is not helpful to consider the concept of “customary” when considering the appropriate size of a “reasonable” provision for contingencies.

C. The Brevity of Important Portions of the USPS Brief Reveals the Weakness of Its Case.

Despite USPS protestations that it has provided a number of reasons for a contingency as large as 2.5 percent of estimated costs, *see, e.g.*, USPS Br. II-6—II-7, the USPS Brief actually discusses the relevant evidence in very summary fashion. As a result, the Brief does not provide any additional support for the USPS position beyond the (unpersuasive) reasons stated by its witnesses, Tayman, Strasser and Zarnowitz. In fact, its brevity reveals its inherent weakness.

For example, The USPS Brief completely ignores the fact that the USPS presentation in this proceeding simply dismisses its own variance analysis without substantial justification. *See* Consortium Br. 8. One is led to the inescapable conclusion that the Postal Service ignored this evidence simply because it would lead to the wrong conclusion.

Moreover, the discussion in the USPS Brief of the current general economic conditions, a factor recognized as relevant to the contingency determination, is limited to two statements. The first statement is:

The general economic uncertainty [was] explained by a renowned economist, Dr. Zarnowitz. USPS Br. II-6—II-7.

The second statement is:

Witness Zarnowitz provided extensive quantitative and qualitative support for the Postal Service’s concerns regarding the uncertain state of the economy. USPS Br. II-9.

It may be true that Dr. Zarnowitz is a “renowned economist.” It is also true that Dr. Zarnowitz provided an “extensive quantitative and qualitative” analysis of the general

economic conditions. The Postal Service's Brief, however, does not address the critical element in Dr. Zarnowitz' testimony: the vague generality of his final conclusion ("there is more uncertainty now than before..."). Tr. 41/18212. The Brief also fails to address the many points illuminated during Dr. Zarnowitz's cross-examination. For example, on cross-examination, Dr. Zarnowitz admitted that he could be reasonably confident in estimates that are only 12-24 months into the future, such as those made by the Postal Service of Test Year costs. Tr. 41/18234.

The Postal Service's Brief is similarly unhelpful in analyzing the other relevant evidence of record and explaining why, in its view, this evidence "supports . . . a 2.5 percent contingency provision." USPS Br. II-10. The failure of the Postal Service's Brief to be more specific when it comes to the evidence of record, and its attempt simply to persuade the Commission to go along with the preference of Postal Service management, is a tacit acknowledgement of the substantive weakness of the Postal Service's position.

D. The Postal Service's Criticisms of Witnesses Buc, Burns and Rosenberg Are Merely Conclusory and Totally Unfounded.

The record in this proceeding contains major presentations on the contingency by a number of witnesses, including DMA *et al.* witness Buc, OCA witness Burns, and OCA Rosenberg, each of whom argues that, based on all the relevant factors, the contingency provision in this case should not exceed 1 percent of postal costs. For example, as witness Buc described in detail in his initial testimony, Tr. 22/9528 *et seq.*, the USPS-proposed contingency of 2.5% is "unreasoned," because it does not take into account all the relevant factors (including a variance analysis), and it is unreasonable, because it is simply too large based upon an analysis of the extent of the uncertainties faced by the Postal Service. Other witnesses, including witnesses Bernheimer and witness Haldi, support the proposition that the contingency should be

substantially reduced from the level requested by the Postal Service. It is particularly revealing that the Postal Service Brief discussed the testimonies of witnesses Buc, Burns and Rosenberg in less than one-and-one-half pages and merely referred briefly to the rebuttal testimony of USPS witness Strasser. USPS Br. II-9—II-10. Again, the brevity of the Postal Service treatment of this (very substantial) testimony is a tacit admission of its strength.⁴

E. Conclusion.

For these reasons, and for the reasons delineated in the briefs of the Consortium, the OCA, and other intervenors, the Commission should include in the revenue requirement a provision for contingencies no greater than 1% of total estimated costs.

III. THE COMMISSION SHOULD APPROVE WITNESS BUC'S PROPOSED REDUCTION IN SUPERVISOR COSTS.

As he did in PRC Docket R97-1, *DMA et al.* witness Buc testified that supervisor costs were overstated by approximately \$92 million because the USPS roll-forward program did not take into account cost savings estimated to be realized in clerk/mailhandler and city delivery carrier costs. Tr. 22/9547-49. The Postal Service Brief treats this subject in one short paragraph that fails to address the merits of Mr. Buc's arguments; it simply reiterates the fact that USPS witness Patelunas has challenged Mr. Buc in his rebuttal testimony, claiming that such a reduction is "inconsistent with operating realities." *See* USPS Br. II-27. The USPS Brief fails to provide any substantial justification for abandoning the conclusion that there is a close relationship between the costs of supervisors and the costs of those supervised. If the Postal Service determines that there is some reason to change the traditional approach to supervisor

⁴ The brevity of this treatment is in stark contrast to the lengthy treatment given the testimony of ANM witness Haldi, whose testimony discusses a relatively modest adjustment in the revenue requirement. USPS Br. II-10—II-26.

costs, the Commission and all interested parties are entitled to a much more complete and convincing presentation than the Postal Service has made in this case.

IV. DMA WITNESS BUC HAS PRESENTED MORE RELIABLE ESTIMATES OF TEST YEAR AFSM 100 SAVINGS THAN POSTAL SERVICE WITNESS PATELUNAS.

Mr. Patelunas makes three conceptually different sets of criticism of Mr. Buc's testimony. The most specific of these, criticism of the numbers employed by Mr. Buc in columns 4, 5 and 6 of Attachment C to Mr. Buc's testimony, Tr. 22/9558, has apparently been abandoned by the Postal Service. There is no mention of this criticism in the short recapitulation of Mr. Patelunas' testimony in the Postal Service's Brief. *See* USPS Br. II-27. This is as it should be. As was demonstrated in the Consortium's Brief, the Buc calculation was based on numbers taken from the Postal Service and Mr. Patelunas had no sound basis for replacing any of them. *See, e.g.*, Consortium Br. 24-26.

The Postal Service Brief does repeat the methodological criticisms of the Buc calculation leveled by Mr. Patelunas: "It ignored piggy-back costs; it made no adjustments for additional floor space; and it excluded allied labor costs." USPS Br. II-27. This recitation does not cure the core flaw in this portion of Mr. Patelunas testimony; he had no idea of how Mr. Buc's presentation should have been altered to respond to these criticisms:

Q And tell me how you would have had Mr. Buc alter his calculation to correctly reflect what you're criticizing him for not reflecting here. What should he have done differently? Look back at page 3 of 3 and tell me what numbers should have changed.

A I don't know if I can sit here and provide a correction to this particular methodology. What I am critiquing here, what I'm criticizing is the combination of numerous optimistic ideal assumptions into one model. I can't – I don't have a correction to provide to this page that would somehow correct all these ideal assumptions that have gone into it.

Tr. 38/17155. There is a good explanation for Mr. Patelunas' inability to prescribe a cure for the Buc calculation. None was appropriate. Recall the context of Mr. Buc's number. It was designed for comparison with the AFSM-related cost savings reported by the Postal Service. Mr. Buc's number was concededly a report of gross savings, not savings net of new costs that might be associated with the new machines. But, as Mr. Patelunas conceded, the Postal Service number with which Mr. Buc was making comparison was also a gross savings number, not a number with cost offsets. Tr. 38/17157. Mr. Patelunas' methodological criticisms are methodologically unsound. They call for comparison of the Postal Service's calculation of gross cost savings with a net savings number.

This leaves the Postal Service with the third category of criticism leveled by Mr. Patelunas at Mr. Buc: "His analysis, moreover, was based on unrealistic assumptions not reflective of the operating environment." USPS Br. II-27. In a very real sense, this is the sole basis for Mr. Patelunas' challenges to Mr. Buc. All of his criticisms seem to come down to this. This criticism depends, at base, on Mr. Patelunas' reliance on the unquantified and unquantifiable "... judgment of field managers who must realize the savings" USPS-RT-4 at 6, Tr. 38/17147. Mr. Patelunas conceded, on cross examination, that there was at least the prospect of intrinsic bias on the part of field managers to understate likely costs savings. Tr. 38/17173.

In choosing between the quantification of AFSM cost savings offered by Mr. Buc and that put forward by the Postal Service, the Commission must choose between crediting the hard numbers contained in Mr. Buc's calculation, all taken from Postal Service testimony, or the assertion by Mr. Patelunas that those numbers are too optimistic and should be replaced by the estimates contained in the often-amended USPS-LR-I-126 that defy quantitative verification

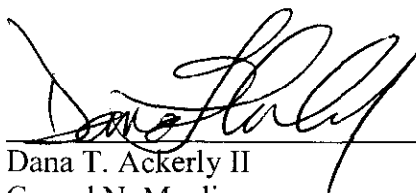
precisely because they are drawn from the nimbus of (possibly biased) managerial judgment.

We respectfully submit that the calculation of Mr. Buc ought to be preferred.

V. CONCLUSION

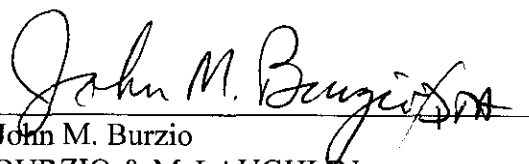
For the reasons stated, the Commission should reduce the Postal Service's estimated revenue requirement for the Test Year by no less than \$1.3 billion.

Respectfully submitted,



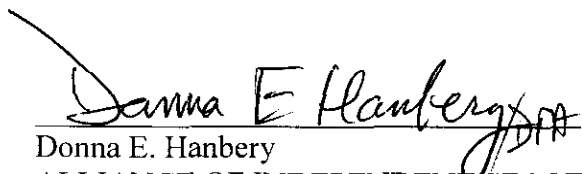
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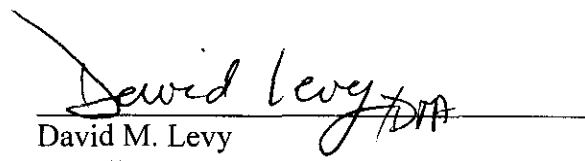
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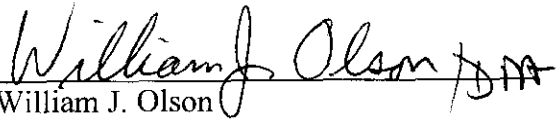
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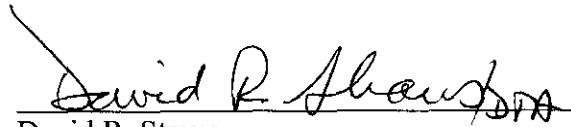
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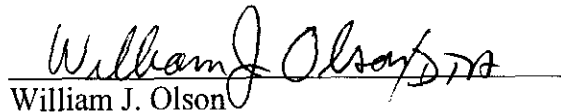
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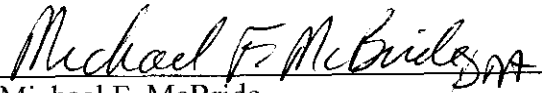
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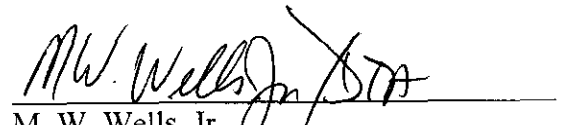
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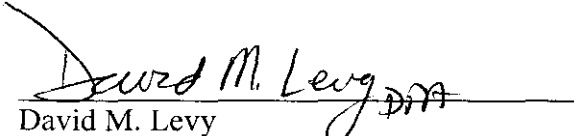
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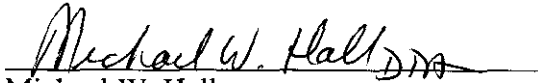
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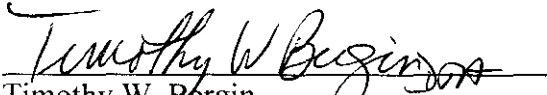
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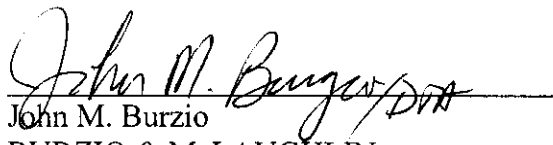
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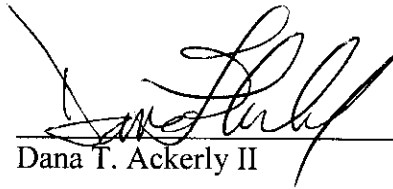
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September 22, 2000

CERTIFICATE OF SERVICE

I hereby certify that I have this date served the foregoing document in accordance with the Commission's Rules of Practice.



Dana T. Ackerly II

September 22, 2000