

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

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Docket No. R2000-1

CONSORTIUM MEMORANDUM
IN RESPONSE TO USPS MEMORANDUM ON RECONSIDERATION

INTRODUCTION

The Direct Marketing Association, Inc. and the parties identified below¹ (collectively, the "Consortium") respectfully submit this Memorandum, which sets forth the Consortium's views on several issues raised by the Postal Service in its Memorandum on Reconsideration filed on December 20, 2000²: (1) the Commission's authority to determine a reasonable contingency; (2) the reasonableness of the contingency approved by the Commission in this case; (3) the Commission's treatment of the Field Reserve as a contingency; and (4) the roll forward supervisory cost savings approved by the Commission.

¹ The parties joining in support of the positions expressed in this Memorandum are: Advo, Inc., Alliance of Independent Store Owners and Professionals, Alliance of Nonprofit Mailers, Amazon.com, Inc., American Business Media, Association of American Publishers, Association for Postal Commerce, Association of Priority Mail Users, Inc., Dow Jones & Company, Inc., Magazine Publishers of America, Major Mailers Association, The McGraw-Hill Companies, Inc., Parcel Shippers Association, Time Warner Inc.

² Memorandum of the United States Postal Service on Reconsideration and Request for Expedition (December 20, 2000) (hereinafter the "USPS Memorandum").

I. IT IS THE COMMISSION'S RESPONSIBILITY TO DETERMINE THE SIZE OF A "REASONABLE PROVISION FOR CONTINGENCIES."

In its Memorandum, the Postal Service makes a number of assertions to the general effect that it, and not the Commission, is the body that has the primary authority and responsibility for determining the size of the contingency provision that forms part of the revenue requirement, USPS Memorandum at 18-28, or, to quote the Postal Reorganization Act of 1970 (the "Act"), providing "sufficient revenues so that the total estimated income . . . will equal as nearly as practicable total estimated costs . . . , including a reasonable provision for contingencies." 39 U.S.C. § 3621.

Thus, the Postal Service asserts that the Commission's reduction of the contingency "interferes with the financial goals of the Postal Service" and that the Commission "has substituted its judgment for that of the Board in fixing the contingency provision." USPS Memorandum at 21. The Postal Service goes on to assert that the Commission cannot exercise its own judgment concerning the proper size of a contingency provision "[a]bsent some extraordinary showing of unreasonableness in the Board's judgment . . ." *Id.* This interpretation of the Act is analytically unsupported and is, quite simply, wrong.

The Act, judicial opinions interpreting the Act, and consistent practice over the past 30 years demonstrate that determining the size of a "reasonable" contingency is an integral part of the ratemaking responsibilities given by Congress to the Commission. That task does not fall within the unreviewable prerogatives of management. Thus, postal rates should be sufficient to meet a revenue requirement that contains a contingency provision determined by the

Commission, as long as the Commission's determination is not arbitrary or capricious and is supported by substantial evidence.³

A. Statutory Background

As has been stated many times by those courts that have addressed the issue, the Act created a unique relationship that balances the responsibilities of an independent, expert, governmental rate-making commission with those of a management modeled upon non-governmental corporations, all for the purpose of providing vital public services in the most economical and efficient way possible. In its initial form, as proposed by the President and introduced in the House, the postal reform legislation of the late 1960's included a rate-making body within the Postal Service whose recommendations could be overturned by the USPS Board of Governors as part of its managerial prerogatives. *See* Postal Reorganization Act of 1970, H.R. 11750, 91st Cong., 1st Sess., §§ 1251-54 (1969). However, the Senate, whose version was ultimately adopted by the Conference Committee, emphasized the need for the public interest to be protected by: (1) setting up an independent commission of experts to scrutinize the Board's rate proposals; and (2) imposing a heavy burden on the Governors if they seek to overrule the Commission. *See* S. Rep. 91-912, 91st Cong., 2d Sess. 13 (1970); *see also* Cong. Rec. S. 12634 (daily ed., Aug. 3, 1970) (statement of Sen. McGee) (stating that the Board "cannot change any recommendation by the Commission unless all nine Governors agree . . . and only then if they can prove that the recommendation of the Commission will not produce sufficient revenue to

³ *See generally Mail Order Ass'n v. U.S.P.S.*, 2 F.3d 408, 420 (D.C. Cir. 1993) (stating that Commission revenue adjustments will be upheld if they are based on "such relevant evidence as a reasonable mind might accept as adequate to support the conclusion" (internal quotation marks omitted)).

operate the Postal Service”). Congressman Udall, in discussing the Conference Report, explained that “we have created an independent establishment within the executive branch and named it the Postal Rate Commission . . .” Cong. Rec. H. 7869 (daily ed. Aug. 6, 1970) (statement of Rep. Udall).

On the important matter of which body would exercise final rate-making authority, Congress crafted an arrangement that is unique among U.S. federal agencies. While the Postal Service is managed in a generally corporate format by a group of executives that report to a Board of Governors, the responsibility for conducting a full hearing on the record under the Administrative Procedures Act for the purpose of determining “reasonable and equitable” postal rates, 39 U.S.C. §3621, is given to the independent Postal Rate Commission, *id.* at §3622. The decisions of the Commission are final, except for limited authority given to the “Governors,” the nine independent members of the Board, who can determine to implement rates different from those recommended by the Commission only under very limited circumstances, including a unanimous decision that the rates approved by the Commission are not adequate to provide sufficient total revenues.⁴

The courts have described this complex statute in various ways in the 30 years since the Act was passed. There is no doubt, however, that ratemaking authority is “vested primarily” in the Commission. *National Association of Greeting Card Publishers v. U.S.P.S.*, 462 U.S. 810, 821 (1983) (hereinafter “*NAGCP IV*”). While the Commission must explain its reasoning and support its decisions with substantial evidence, *see United Parcel Serv., Inc. v. U.S.P.S.*, 184 F.3d 827, 838 (D.C. Cir. 1999), the Governors (not the Board of Governors) can

⁴ See 39 U.S.C. §3625; *Time, Inc. v. U.S.P.S.*, 685 F.2d 760, 771 (2d Cir. 1982).

overrule the Commission only after carrying a “heavy burden” of explaining why the Commission’s proposals are inadequate, and doing so unanimously, *Time, Inc. v. U.S.P.S.*, 710 F.2d 34, 37 (2d Cir. 1983). The Board of Governors, on the other hand, “is the business manager of the Postal Service.” *Id.* at 40.

Thus, the Board of Governors and Commission have powers that often intersect, but, as the D.C. Circuit has stated: “There is no indication that Congress contemplated that either ‘partner’ would trench on the functions and prerogatives of the other” *Governors v. Rate Commission*, 654 F.2d 108, 114-15 (D.C. Cir. 1981). Each entity has certain functions that are within its particular sphere of authority, and the Commission deserves deference so long as its decision is within its jurisdiction, is based on substantial evidence, and conforms to the criteria set forth in the statute.

The crucial issue, then, is whether the postal ratemaking scheme crafted by Congress treats the determination of the size of a “reasonable provision for contingencies” as being within the management prerogatives of the Board of Governors or whether it is one of the many issues that are appropriate for determination by the independent body of rate-making experts, the Postal Rate Commission. If the contingency falls within the Commission’s authority, then, like all the other issues underlying the Commission’s rate recommendations, the Commission’s determination must be upheld unless it is either “arbitrary or capricious” or unsupported by “substantial evidence.”

B. The Contingency Is an Unexceptional Element of Postal Rate Calculations and Falls Squarely Within the Purview of the Commission.

The Postal Service’s suggestion that the Commission lacks authority to review the reasonableness of the contingency allowance proposed by the Postal Service is at odds with three decades of Commission decisions doing just that. Moreover, the Commission’s longstanding

assertion of authority to review the contingency is well-supported. A number of factors lead inexorably to the conclusion that the determination of the size of a “reasonable” contingency falls within the scope of the Commission’s responsibility and not within the Board’s managerial discretion.

First, the plain language of the Act requires this result. Title 39 directs the Commission to make its recommended decisions “in accordance with the policies of this title,” 39 U.S.C. § 3622(b). The requirement in Section 3621 that the “provision for contingencies” must be “reasonable” is one of these policies, and there is nothing in the Act directing the Commission to exclude this policy from its consideration or to treat this policy in a manner different from all the other relevant statutory policies. For example, Congress did not include in Section 3621 phraseology such as “a provision for contingencies as may be determined to be reasonable by the Board of Governors;” nor is there any other language that would indicate a Congressional intent that the contingency be a matter for management discretion.

To the contrary, Congress’ qualification of the phrase “provision for contingencies” with the term “reasonable” indicates an intent that the size of the contingency would be subject to discussion and analysis in Commission proceedings, and therefore not determinable in the discretion of anyone. Indeed, the phrase “reasonable provision for contingencies” echoes the use of the term “reasonable” earlier in Section 3621, in the phrase “reasonable and equitable rates of postage,” again referring to issues expected to be litigated and then determined through the exercise of Commission expertise.

Second, the concept of a “provision for contingencies” contains nothing that would render it inherently managerial in character. The Governors’ Decision suggests to the contrary when it states that the contingency may under certain circumstances produce net

revenues that “contribute[] to the Board’s policy options regarding its determination of the timing of future rate increase and the restoration of equity.” Governors’ Decision at 11. That may very well be true: more money almost always means more “policy options” for any enterprise. However, this fact cannot shield the contingency from Commission scrutiny. The same logic would bar the Commission from reviewing *any* element of the Postal Service’s overall revenue requirement, a result the Postal Service has never espoused. Issues are properly “managerial” (in the sense of reserved to the Postal Service’s discretion) only when they concern such operational matters as the selection of vendors, the location of new post offices, the hiring and firing of employees, and the timing of rate cases.

It is plausible that the Governors were trying to lay the foundation for an argument that the contingency falls within the scope of *Newsweek, Inc. v. U.S.P.S.*, 663 F.2d 1186 (2d Cir. 1981). Any such argument would be totally without merit. In *Newsweek*, the Second Circuit voided the Commission’s revenue adjustments as having unlawfully intruded on the Board’s authority. In that case, the Commission’s actions were overruled precisely because they were not based on the statutory criteria but were designed to discipline the Board. *Id.* at 1204. Moreover, the Commission’s decision to strip the Postal Service of \$1 billion in revenue in that case had the effect of imposing the Commission’s view that rate cases should be filed more frequently, and the decision as to when to file a request for changed rates and fees is within the authority given to the Board exclusively. *Id.*

The *Newsweek* court made clear that the Commission could adjust the revenue requirement under 39 U.S.C. § 3621 if the Commission’s action rested on reasoned findings and relevant statutory criteria. *See id.* at 1205 (directing the Commission, if it modified the revenue requirement on remand, to “subject its productivity adjustment rationale to the same hearing

process as all other materials upon which it bases its recommend decisions,” and “articulate its reasons for any modification of the schedule proposed by the Board”).

The Commission’s action in the present case is clearly consistent with *Newsweek*. The Commission’s findings and decision betray no attempt to manipulate the timing of future rate cases, or otherwise intrude into the managerial discretion of the Governors. The Commission made a thorough analysis of the extensive evidence on size of a reasonable contingency and simply reached a conclusion different from the position espoused by the Postal Service.⁵

In any event, the USPS Memorandum appears to have disavowed any reliance on *Newsweek*. The Memorandum states that “[t]here are no particular goals other than those of the contingency provision itself: to provide a cushion sufficient to ensure that the Postal Service can both operate as required and break even, even in the face of unforeseen events or circumstances.” USPS Memorandum at 19. The Memorandum states the correct legal principle. The

⁵ Contrary to the Postal Service’s suggestion, USPS Memorandum at 21, that there was “novel reliance” by the Commission on a new ratemaking methodology, the Commission employed the OCA analysis at issue in an entirely traditional fashion:

“OCA’s point is that the appropriate size of the contingency should be related to the size of the requested increase in revenues. The corollary is that large forecast error is more likely when projecting large changes (for example in a period of rapid inflation) than when projecting small changes (for example during stable economic times.) The Postal Service projects small, gradual increases in operating expenses that will result in a test year deficiency in operating revenues of approximately 2.6 percent assuming nor rate increase. OCA contends that as economic conditions have been shown to be stable, OCA Brief at 43-51; and other causes of projection forecast error have been dramatically reduced, *Id.* at 53-55; there is no valid justification for a sharp increase in the size of the provision for contingencies.” Op. R2000-1 at ¶ 2167.

contingency was not included in Section 3621 as a management tool or for any purpose other than to provide assurances that the Postal Service would be able to operate on a sound financial basis in the event of unforeseen and adverse financial developments. Thus, there can be no argument that the size of the contingency provision is within management's discretion because it is necessary for the accomplishment of some other purpose that is inherently managerial in character.

Third, the Postal Service's approach is inconsistent with long-standing rate-making practice. If the contingency is within management discretion, why has the Postal Service been in the position of needing to justify its contingency request in all the rate cases over the past 30 years? Contingency proposals have always been subjected to careful scrutiny, including cross-examination of the witnesses supporting the USPS-proposed contingency amount. It would be strange indeed to hold that modifying the contingency request impermissibly intrudes on management's authority, after the issue has been litigated as an integral part of every rate proceeding under the Act. This consistent practice confirms that the contingency has been understood to be within the Commission's ratemaking authority and not within management discretion. This practice cannot be challenged now simply because the Postal Service does not like the result in this case.

Fourth, the need for Commission review of the contingency is underscored by its close nexus with other rate-making factors that Congress entrusted to the Commission. For example, while a large contingency might increase the level of confidence that the Postal Service would not operate at a deficit under any circumstances in the test year, it would also have the effect of shifting postal costs to current mailers from future mailers. This form of cross-subsidy would be inconsistent with the fundamental principles embodied in the Act. Each rate-making

factor is, in fact, properly part of a complex balancing act that only the Commission can perform based on all the evidence of record. As a result, only the Commission is able to assess what is a “reasonable” contingency in light of both the Postal Service’s needs and the public interest. *See* S. Rep. No. 91-912 at 13 (stating that “the independence of the Commission will serve a vitally important function by permitting [it] to view the overall impact of postal costs with a degree of detachment which the committee considers vitally important to serve the public interest . . .”). In other words, the reasonableness of the contingency must be determined by weighing the financial burden on the mailing public against the financial risks being run by the Postal Service.

To phrase the matter slightly differently, the decision as to the size of the contingency requires the exercise of the experienced judgment that Congress intended the Commission to bring to the ratemaking process. *See NAGCP IV*, 462 U.S. at 822 (stating that Congress intended to place ratemaking in the hands of “professional economists, trained rate analysts, and the like” (internal quotation marks omitted)).

For all of these reasons, the question of what is a reasonable contingency is part and parcel of the Commission’s function and does not require the Commission to meet any heavy burden for it to be accorded validity. Under the statutory scheme, the Commission’s determination of the size of a “reasonable” contingency must be upheld if it is supported by substantial evidence.⁶

⁶ The Consortium recognizes, of course, that the Governors have the final word on the adequacy of the Commission’s recommended revenue requirement to meet the total estimated costs of the Postal Service. The Governors were given this final authority in Section 3625, but it is circumscribed by important constraints, including the requirement that the Governors exercise their “modification” authority by acting unanimously. Indeed, the explicit grant of authority to the Governors under Section 3625 reinforces the conclusion that the Commission has important responsibilities to determine the Postal Service’s revenue needs in its recommended decision pursuant to proceedings under Sections 3621, 3622 and 3624.

II. IN THIS CASE, THE COMMISSION'S DETERMINATION OF THE CONTINGENCY PROVISION WAS AMPLY SUPPORTED BY THE EVIDENCE OF RECORD AND SHOULD BE AFFIRMED.

In its opinion, the Commission took a moderate course, rejecting both the Postal Service's 2.5% request and the positions espoused by members of the Consortium, the OCA and other intervenors that the contingency should not exceed 1%, or that there should be no contingency at all. The record amply supports the Commission's judgment that a 1.5% contingency is reasonable and appropriate. The Commission should affirm this judgment.

In its Memorandum, the Postal Service challenges the Commission's determination, reiterating its previously stated positions and alluding to economic developments that have occurred, or are alleged to have occurred, since the record closed. To the extent that the Postal Service repeats arguments made earlier, it is simply expressing its continued disagreement with the Commission's judgment. It should be noted, of course, that many members of the Consortium disagree with the Commission's judgment, as well; they were convinced that the contingency should be no larger than 1%. However, the Consortium agrees that it is the Commission's judgment that should control and acquiesces in its conclusion.

To the extent that the USPS Memorandum discusses events or factors that do not appear in the record, it is seeking to sway the Commission's decision based on impermissible, extra-record evidence that should not be considered because it has not been subjected to cross-examination or rebuttal. In order to avoid committing reversible error that would raise serious concerns about the status of any revised rates that might be implemented thereafter, the Commission should give no weight to these portions of the USPS Memorandum.⁷

⁷ The Governors' reliance on the alleged deterioration of the Postal Service's earnings since the close of the administrative record is at odds with the Postal Service's posture in Docket (continued...)

The Consortium believes that the Commission's Recommended Decision contains a thorough discussion of the evidence of record relevant to the contingency issue and that this discussion amply supports the Commission's determination. To revisit these issues here, therefore, risks imposing unnecessarily upon the Commission's time. Nevertheless, we will summarize below the most salient portions of the relevant evidence.

First, the variance analysis, which is main objective evidence in the record, supports the contingency proposal. Witness Buc explained, in unrebutted testimony, that "unlike either of the last two [rate] cases, witness Tayman has proposed a contingency higher than any of the variances produced by the variance analysis." Tr. 22/9543; *see also id.* at 22/9822-24. In R97-1 the contingency was within the range covered by the variance analysis, and in R94-1 the contingency was smaller than the one produced by analysis. Tr. 22/9544. Thus, proper consideration of the variance analysis should lead to a lower contingency than proposed by the Postal Service.

Recognizing this problem, the Postal Service has expressed its "disagreement with the notion that analysis of past estimates provides a basis for determining the appropriate contingency for the future." USPS Memorandum at 20. Once again, the Postal Service is trying

No. R97-1. As the Commission is aware, the part-year financial reports issued by the Postal Service after the outset of Docket No. R97-1 indicated that the test year financial projections underlying the rate request were unduly pessimistic. The Postal Service vigorously argued throughout Docket No. R97-1, however, that no weight should be given to these partial-year financial results. *See, e.g.*, Docket No. R97-1 Reply Brief of the USPS (Apr. 10, 1998) at I-9 ("Partial-year results do not provide a reasonable basis for supporting changes in test year estimates."). The Governors ultimately implemented the \$1.6 billion revenue increase recommended by the Commission in Docket No. R97-1 despite finding that the existing rates were likely to generate a "net income" (i.e., operating surplus) in FY 1998, the test year. R97-1 Decision of the Governors (June 29, 1998) at 22.

to rewrite the rules because it does not like the result in this proceeding. For the reasons stated by the Commission, the variance analysis and the other objective data adequately support the result here.

Second, the only evidence offered by the Postal Service in support of its request for \$1.68 billion contingency consisted of subjective management opinions or entirely foreseeable factors that are not a valid basis for a contingency. Witness Tayman's justification of a 2.5% contingency is limited to a mere 3 pages of his testimony, USPS-T-9 at 43-6, and the bulk of this limited treatment is devoted to trying to explain why he did not rely on the variance analysis he presented. Tayman openly proclaims that the 2.5% contingency was based on a "largely subjective" determination. USPS-T-9 at 43. Consistent with his testimony, he provided no studies, data, or supporting information to support the contingency request, in spite of numerous requests from The DMA and the OCA. Moreover, Tayman conceded that his specific assertions made in support of his subjective opinions were already accounted for in the rollforward model.⁸ In sum, all that Tayman offers the Commission is his personal conviction that the Postal Service needs a contingency of the requested size. That does not constitute substantial evidence and was properly given little weight by the Commission

Acting CFO Strasser's testimony fared no better. First, Strasser stated that a 2.5% contingency is justified because it is well-within the range of the contingencies approved in prior rate cases. Tr. 46/20183-184. This point was unpersuasive for several reasons. First, a contingency request must be based on record evidence in the pending proceeding, not on

⁸ Tr. 2/280; *see* Tr. 22/9820-21. Moreover, Tayman conceded to Chairman Gleiman that \$450 million of the contingency was intended to cover the fact that new rates are not expected to go into effect until several months into the Test Year, a fact that is irrelevant to the size of a "reasonable" contingency provision. Tr. 2/561-63.

extrapolations of past cases. Contingencies approved a decade or two ago in an era of volatile inflation, oil embargoes, high budget deficits, and political uncertainty cannot be meaningfully cited under present circumstances. *E.g.*, Tr. 22/9816-17.

Next, Strasser suggested that uncertainties in the general economy support a large contingency. Tr. 46/20189-191. Even if one had been worried last Fall that the longest economic recovery in history would eventually falter, the record before the Commission supported its view that these fears were exaggerated insofar as they related to the Test Year (*i.e.*, the next 13 months). For example, witness Zarnowitz conceded that economic forecasts are quite reliable over a one-year period, and that only after two years do they become seriously suspect. Tr. 41/18234; *see id.* at 41/18308. Moreover, neither Strasser nor Zarnowitz ever explained why the economic risks they are worried about are not already reflected in the Postal Service's Test Year estimates. Indeed, as recently as July the Postal Service produced new ECI numbers that account for the evolving economic circumstances that troubled Strasser. Despite this effort to fine-tune its estimates of Test Year financial performance, the USPS did not modify its contingency request. For the foregoing reasons, uncertainty in the general economy, as reflected by record, could not support the large contingency requested by the Postal Service.

Finally, Strasser argued that the Postal Service needs a higher contingency to restore equity. Tr. 46/20199-200. Even if restoring equity were an important policy goal, that goal could not support a contingency request, because equity restoration is not an unforeseen expense. To the extent that Strasser suggested that the Service needed a large contingency to guard against the need to borrow more money, that is the appropriate function of the prior-years-loss recovery provision, not the contingency. *See* Tr. 22/9809.

Thus, the only two witnesses supporting a 2.5% contingency failed to advance a single persuasive argument. There is record evidence (submitted by the Consortium, the OCA and others) that no more than a 1 percent contingency was justified. The Commission found the OCA presentation “particularly convincing”. Op. R2000-1 at 76, ¶2173. Compromising between these two limits is clearly within the Commission’s authority. *See, e.g., Association of American Publishers Inc. v. Governors of U.S. Postal Service*, 485 F. 2d 768, 773 (D.C. Cir. 1973) (“Since Solomon’s day, to split the difference or to come close thereto has been thought wise, if only because it makes parties more likely to disclose to tribunals the truth.”)

Accordingly, the Commission should affirm its earlier determination that a 1.5% contingency provision is reasonable.

III. THE COMMISSION’S TREATMENT OF THE FIELD RESERVE AS PART OF THE CONTINGENCY WAS APPROPRIATE.

The Postal Service and the Commission have approached differently what the Postal Service characterizes as an unallocated field reserve of \$200,000,000 designed to reflect the uncertainty of success of a program of “breakthrough productivity” announced by the Postmaster General in March of 2000. The Postal Service urges that a \$200,000,000 reserve to hedge against the failure to accomplish the \$744,000,000 of productivity gains estimated by the Postal Service to be accomplished in the test year should be treated as an expense in that year, increasing the revenue requirement by \$200,000,000.⁹ The Commission viewed the matter differently. It recognized that the prospect of a savings shortfall was not at all certain but a contingent occurrence that should be weighed with other uncertainties when gauging the

⁹ As expressed in Patelunas’ initial response to POIR No. 14, the reserve is expressed as a reduction in cost savings, but the result is the same whether expressed as a reduction of a negative number or an increase in a positive number.

appropriate magnitude of the contingency reserve. We believe that the Commission has decidedly the better position in this dispute.

It is an imperative part of the Commission's function to identify clearly the costs that cumulate to the revenue requirement. Failure to do this would make it impossible for the Commission to determine, as it must under the statute, whether the rates contained in a recommended decision meet the requirements of 39 U.S.C. § 3622(b) (and particularly § 3622(b)(3)) and that the breakeven standard in Section 3621 is satisfied by the rates. Amounts that are wholly uncertain, such as the field reserve, defy such quantification. There is a statutory device for dealing with such uncertainties, the provision for contingencies.

Strasser's description of the field reserve, when contrasted with his description of the contingency reserve, powerfully makes the case that the amount at issue is much more appropriately treated as part of the contingency than as a test year expense. This is how Strasser described the field reserve:

"It has not yet been assigned to a particular expense account, pending evaluation in the field of the particular needs of each location as the year progresses. Its status is similar to a series of other reserved line items in the Postal Service's budget process. For example, budgeted field expenses for projected COLAs and increased health benefit expenses are held in a headquarters reserve account at the beginning of the year. They are not allocated to field operating units until well into the budget year, when the actual CPIs (in the case of COLAs) and the actual health benefit increases are known. The reserve is then distributed to the field as needed as the year progresses. In the same way, the breakthrough productivity field reserve will be distributed as needed as the year progresses, once it is known where and for what the funds are needed. Breakthrough productivity is most certainly not a new contingency provision beyond what was included in the Postal Service's request. To the contrary, it represents a new level of increased risk for the Postal Service, further supporting the need for the Postal Service's 2.5 percent contingency provision."

USPS-RT-1 at 27-28, n.6; Tr. 46A/20207-08.

This is how Strasser described the contingency reserve:

“The contingency is an insurance policy, and it’s – the advantage of it is that if it’s not needed, it’s not used, and it’s not going to go away. When you and I pay our insurance policy, if our house doesn’t burn down, the insurance company pockets it assuming that they haven’t had any catastrophes. But in this case, the Postal Service contingency is used for other purposes, perhaps to prolong time between rate increases, perhaps to invest in infrastructure; but the ratepayer who pays the contingency as an insurance for the test year receives benefit from that payment. It’s not like it’s going away.”

USPS-RT-1 at 28; Tr. 46A/20239.

The only direct evidence of the existence of the field reserve is its asserted presence in the budget for the test year. This is a powerful indication of the impropriety of treatment of this amount as a test year expense. The budget for the test year is not available as evidence on which the Commission could rely because it was not produced in the proceeding. *See, e.g.*, Tr. 46A/20174.

It is also the case that the purpose of the field reserve is much more comparable to that of an insurance policy than that of a confidently predictable expense. The reserve was conceived of as a hedge against the prospect that the Postmaster General’s optimism concerning savings in the test year might have proved too aggressive and that actual savings in that year would fall below projection.¹⁰ The purpose of the field reserve is to protect against an event that is not certain to occur, the prospect that anticipated breakthrough productivity savings will not mature. It is an insurance policy against a possible future occurrence that it may never come to pass.

¹⁰ The Postmaster General called for a savings of one billion dollars in each of the four years 2001 – 2004. The magnitude of savings projected in the Test Year was compared to \$550 million (Response of United State Postal Service Witness Tayman to Presiding Officer’s Information Request No. 13, Tr. 46D/21855-56) or \$544 million, (Response of United States Postal Service Witness Patelunas Presiding Officer’s Information Request No. 14 at Attachment I, Tr. 46D/21595) by the Postal Service.

The fact, asserted by Strasser, that if the field reserve is not put to the use for which it was designed -- that is, if all of the anticipated efficiencies are accomplished and there is no productivity shortfall -- the money represented there will be put to other uses, does not change any of this. *See* Tr. 46A/2095. There is no guarantee that the outcome projected by Strasser will come to pass. And even were the Test Year budget in evidence, this alternate disposition of the \$200 million would have no evidentiary basis because the budget can not reflect the use of the \$200 million for more than one purpose. A revision to the budget (if it now exists) would be necessary to assure the outcome predicted by Strasser. If a change in the budget is made, at least two of the items on Strasser's second reserve, mail transport equipment and information platform infrastructure, appear to be capital items. It is, of course, impossible on the present record to test whether they have been properly capitalized.

For these reasons, the Commission should reaffirm its decision on the field reserve.

IV. THE SUPERVISOR COST SAVINGS APPROVED BY THE COMMISSION WAS CORRECT.

In this case, the Postal Rate Commission rejected the Postal Service's contention that reductions in craft labor caused by cost reduction and other programs would not be accompanied by reductions in the supervisors of this labor. Instead, the Commission accepted that reductions in labor would induce proportional reductions in the supervision of this labor. The Postal Service has asked the Commission to change its decision upon reconsideration. The Commission should deny that request.

The USPS Memorandum asserts that changes in craft labor will not be accompanied by changes in supervisory labor. USPS Memorandum at 11 - 17. The Memorandum first states that the Commission "ultimately relies directly on statements contained

in a document entitled "Summary Description of USPS Development of Costs by Segments and Components, Fiscal Year 1998". The Service also notes that while this document is a Category 1 library reference, it was never formally admitted into evidence.

While the Service is correct that the Commission did cite the Summary Description, the Commission also referenced paragraph 2154 of its Opinion in R97-1, which states:

"the Service never discusses why the supervisor ratio should change under cost reduction programs.... The Service offers no testimony bearing on the issue and just repeats the assertion that Buc incorrectly believes that program managers did not consider the effect on supervisors' costs. . . . The Service seems to have no explanation for its failure to make a corresponding adjustment in supervisors' work hours when craft employees' work hours are reduced."

(Citations omitted). The Memorandum goes on to assert that "[t]he Commission's Opinion misapprehends the nature of the 'Summary Description' document." The Summary Description, according to the Service, describes the relationship between supervisors and crafts under a given operating plan. In short, the memo asserts that the cost reduction programs change the operating plan of the Postal Service so that the ratio of supervisors to craft hours will change. It also asserts that the relationship between supervisor and craft labor hours will obtain only in the long term.

While the Memorandum asserts that the cost reduction programs induce changes in the operating plan, it does not cite persuasive record evidence to prove this assertion. The Memorandum cites only the testimony of Patelunas at Tr. 37/17143 to support this point. Here, Patelunas states:

"For instance, I am informed that with more machines, an on-line keying room, the speed of the new machines, the additional number of sort plans, etc., maintaining the same ratios of supervisors would mean that each supervisor would be responsible for a considerably larger portion of the flow of mail. There is, however, a limit on what each individual supervisor can be responsible for."

From this testimony, it appears that not only does Patelunas have no first-hand knowledge of how changes in operating conditions affect changes in supervision, but that he is testifying that supervisors do not supervise people, but instead supervise mail flow. This seems unlikely. According to USPS LR-I-107, feeding productivity for Delivery Point Sequencing (DPS) on a bar code sorter in FY 1998 was 13,334 pieces per person per hour, while productivity for manual letters in outgoing secondary was 477 pieces per hour. Thus, one craft employee in DPS would generate about the same "mail flow" as 30 employees in the manual operation. According to Patelunas, then, one employee in DPS would require the same number of supervisors as 30 employees in the manual operation.

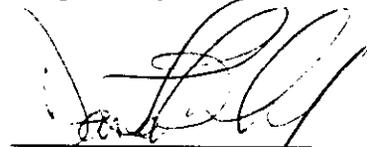
It is also important to note that nowhere other than the "Summary Description" Library Reference does the Postal Service provide record evidence describing the operating plan either before or after the implementation of the cost reduction programs to allow an evaluation of how the cost reduction programs change the operating plan. We have only Patelunas' description of his second-hand "inform[ation]."

Accordingly, the Commission should reaffirm its prior decision on the rollforward cost savings program.

CONCLUSION

As discussed above, the Commission should reject the arguments made by the Postal Service in its Memorandum on Reconsideration.

Respectfully submitted,



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Dated: January 12, 2001

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

January 12, 2001