

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

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DOCKET NO. R2000-1
OFFICE OF THE SECRETARY

VAL-PAK DIRECT MARKETING SYSTEMS, INC.,
VAL-PAK DEALERS' ASSOCIATION, INC., AND
CAROL WRIGHT PROMOTIONS, INC.
COMMENTS REGARDING UNITED STATES POSTAL SERVICE'S
MEMORANDUM ON RECONSIDERATION
(January 12, 2001)

Pursuant to Order No. 1301, Val-Pak Direct Marketing Systems, Inc., Val-Pak Dealers' Association, Inc., and Carol Wright Promotions, Inc. (hereafter "Val-Pak/Carol Wright") file the following comments regarding the United States Postal Service's December 20, 2000 Memorandum on Reconsideration and Request for Expedition.

STATUS

On November 13, 2000, the Postal Rate Commission issued its Opinion and Recommended Decision in Docket No. R2000-1, recommending rates and fees for all domestic postal products and special services. The Commission estimated that its recommended rate increases would produce test year revenues of \$68.819 billion, only \$280 million less than the revenue estimate in the request of the United States Postal Service filed on January 12, 2000.

On December 4, 2000, the Board of Governors of the United States Postal Service issued two decisions in response to the Commission's Opinion and Recommended Decision. One decision allowed the recommended rates, fees, and certain classification changes to be implemented under protest on January 7, 2001, while remanding the case back to the Commission for reconsideration. Specifically, the Governors asserted that the test year

revenue requirement for the Postal Service should be increased; not merely by adding in the \$280 revenue million reduction the Commission's numbers substantiate, but by adding almost \$1 billion into the Postal Service's bottom line. The Governors' second decision rejected several classification changes contained in the Opinion and Recommended Decision.

In response to the Governors' remand of the case, the Commission issued Order No. 1301 on December 11, 2000. This order provided formal notice to participants in Docket No. R2000-1 that the Board of Governors had remanded the docket for reconsideration and established two alternative schedules for further proceedings.

Within the time period for the more expedited of the two schedules, on December 20, 2000, the Postal Service filed its Memorandum on Reconsideration and Request for Expedition (hereafter "USPS Memo"). This memorandum, whose principal arguments seeking additional funds are discussed at length below, also sought a modification of the schedule established by the Commission in Order No. 1301. Commission Order No. 1302, issued on December 21, 2000, rejected the Postal Service's proposed expedited schedule.

INTRODUCTION

The Governors' decision remanding Docket No. R2000-1 (at p. 3) identifies three "major" issues for reconsideration, each of which reflects specific amounts eliminated by the Commission in its Recommended Decision from the Postal Service's requested revenue requirement. The Postal Service seeks to obtain on remand recommended rates and fees which

would fund an additional (i) \$200 million designated as a “Field Reserve,” (ii) \$97 million related to supervisory cost savings, and (iii) \$687 million in contingency funds.¹

Val-Pak/Carol Wright herein respond to the Postal Service’s purported justifications in support of the proposed additional Field Reserve and contingency funding, and associate themselves with the filing of the Direct Marketing Association, Inc. and the coalition, which is also filing comments today, *inter alia*, with respect to the issue of supervisory cost savings.

DISCUSSION OF SELECTED ISSUES

The Field Reserve

The Postal Service’s discussion of the Field Reserve (USPS Memo at 8-11) is, at best, confusing. For example, the Postal Service quotes the testimony of its witness Strasser, observing in the first instance that the Field Reserve **might be used** for expense items such as COLAs or health benefits. The Postal Service next quotes witness Strasser’s cross-examination testimony observing that the Field Reserve **might not** be spent on expense items, in which case it would be used **for investment** in various items such as **mail transport equipment or information platform infrastructure**.²

¹ Commission Order No. 1301, p. 2. Also discussed in the USPS Memo at 3-4 are three other “minor” technical issues, regarding which Val-Pak/Carol Wright offer no comments.

² Postal Service witness Strasser is quoted in the USPS Memo at 9 as stating that “we have a list of investments that should be made, and there is [sic] too many on the list to fund....”

The Postal Service's assertions regarding the nature of the Field Reserve are inconsistent. To the extent that some or all of this reserve was spent on capital investment, the cash indeed will flow out during the year of purchase, but the full amount expended for capital investment does not represent a current "expense" under the accrual method of accounting used by the Postal Service.³ Expenditures for investments are capitalized and depreciated over an appropriate number of years. Assuming that any such possible expenditures would be incurred later in the fiscal year, after the Postal Service has ascertained that the Field Reserve would not be needed for items such as COLAs or other contingencies that are appropriately expensed as incurred, the maximum appropriate expense to include in the test year revenue requirement for such capital investments would amount to only a small fraction of one year's depreciation.

Nor is it appropriate to use the Field Reserve (or the contingency, if the Field Reserve be considered to be excluded from the contingency) in any systematic way to fund capital investments on a pay-as-you-go basis. Efforts to establish such a new policy as to a Field Reserve are unwise and should be rejected.

The Postal Service has a capital investment budget which was discussed at length during the course of the docket. If the Postal Service's unfunded investment projects have a

³ The Postal Service attempts to make much of the fact that the Field Reserve "will be spent, either to fund field operations, if needed, or on already approved [capital investment] projects that have been deferred pending evaluation of the progress of the breakthrough productivity initiatives." USPS Memo at 10. The Postal Service fails completely to distinguish between the appropriate accounting treatment for field operation expenditures, which are appropriate to expense in full, and capital investments, only a portion of which are expensed in the year the funds are expended.

payback which exceeds their cost (including interest), then for the good of mailers and the Postal Service those investments should be undertaken and funded in the usual manner (*i.e.*, using cash flow from depreciation plus borrowing). Capital investments should not be commingled with current expense items and surreptitiously funded in this fashion.

Should the Commission accede to the Postal Service's proposed "Field Reserve," in addition to the contingency, it is important to contemplate what might result in the future. With such a precedent in hand, in the next omnibus rate docket, the Postal Service, in its discretion, could decide to earmark not just \$200 million, but perhaps \$2 billion or more as Field Reserve, with plans to spend any unused amount on its undoubtedly large backlog of unfunded investment projects. If permitted, a vaguely-justified Field Reserve, such as that defended by the Postal Service, in addition to the "contingency," would provide the Postal Service with an open door to pad its revenue requirement in future rate cases.

If any part (or all) of the Field Reserve were not required to be spent on the contingent expense items identified by witness Strasser, and if no other unforeseen events were to occur that require the unexpended portion of the Field Reserve, then those unexpended funds — as a first accounting step — should be counted as a contribution to the year-end surplus. The Board of Governors, of course, has full discretion with respect to how any surplus is spent, and the Board could then decide whether to allocate some or all of the surplus for items on the Postal Service's list of unfunded investment projects. But the preceding procedure is not the same as earmarking some funds for a specified subset of contingencies (such as COLAs) and simultaneously allocating any unexpended portion of that subset of contingent funds for investments on the Postal Service's unfunded projects list. At a minimum, any such internal

budget “policy” or “shortcut” procedure disguises the amount available for surplus or other contingent needs, and by so doing it may also have the effect of limiting or reducing the Board’s discretion.

The Postal Service concludes its discussion of this issue with the statement that “[the Field Reserve] will not be available to fund contingencies and its inclusion in the contingency provision effectively reduces the contingency further to 1.2 percent, contrary to the Commission’s conclusion that a contingency of 1.5 percent is needed.” USPS Memo at 11. This conclusion conflicts, however, with the Postal Service’s implicit acknowledgment, cited above, that the initial prospective application of the Field Reserve would be, in fact, to meet needs that may or may not materialize — *i.e.*, for “contingent” possibilities.

Contingency

The Postal Service begins its argument regarding the supposed proper contingency amount by defending witness Tayman’s testimony concerning the contingency, and attacking the Commission’s approach. USPS Memo at 18. The Postal Service seeks to impose on the Commission the burden “to explain why such testimony, which was adequate in the past, is no longer adequate.” *Id.* Later, the Postal Service states that “[f]inally, the Governors took issue with the Commission’s novel reliance on the OCA’s analysis of the percentage of the total increase in revenue represented by the contingency provision.” *Id.*, p. 21. The two preceding quotations should be seen as closely related, even though they are separated by more than two pages of discussion.

First, it was not merely the OCA's analysis on brief that the Commission found compelling — the OCA's analysis was preceded by witness Haldi's testimony for Val-Pak/Carol Wright, which analyzed the Postal Service's requested contingency in terms of a percentage of the total requested increase in revenue. VP/CW-T-1 at 35-37, Tr. 32/15790-92; *see Op. & Rec. Dec.*, paras. 2103-2105. The OCA expanded upon this analysis, helpfully incorporating data from prior rate filings showing the requested contingency as a percent of the total increase in revenue. OCA Initial Brief, Table 1. By this standard, the requested contingency in this case — 60 percent of the revenue increase, versus a previous high of 34 percent — more than doubled most previous requests, as shown in Table 2-1 (para. 2166, p. 73) of the Commission's Opinion and Recommended Decision. The extraordinarily high and unprecedented request for contingency in Docket No. R2000-1 demands far more than the perfunctory justification proffered by witness Tayman, regardless of whether such type of justification has been considered adequate in some prior dockets. The Postal Service's request in this docket, proposing a rate increase driven more by amorphous contingencies (both explicit and implicit, such as the Field Reserve) than by estimated cost increases, is not supported in the record.

Notwithstanding the Governors' assertions to the contrary, Val-Pak/Carol Wright submit that "the percentage of the total increase in revenue represented by the contingency provision" adds an important perspective to any examination of the reasonableness of the requested contingency. Viewed from this perspective, the Postal Service request has not "returned to a traditional level of contingency protection," despite the Postal Service's assertion that it has. USPS Memo at 19.

The revenue requirement approved by the Commission includes an amount for recovery of prior years' losses and restoration of equity. For many years this practice has been deemed by the Postal Service, the Commission and mailers — *i.e.*, by virtually all parties — to be fair. Postal Service counsel argue from the Governors' Decision that "[t]he possibility of net incomes contributes to the Board's policy options [at mailers' expense] regarding its determination of the timing of future rate increase [sic] **and restoration of equity.**" (Emphasis added.) USPS Memo, p. 21. In their reference to restoration of equity, however, the Governors apparently consider the contingency provision as a means by which they can include surreptitiously even larger amounts for speedier recovery of prior years' losses. But that is "no way to run a railroad" — or the Postal Service. If the Governors are not satisfied with the current approach (one-ninth of accumulated prior years' losses each year), the appropriate procedure would be to **seek a more accelerated provision explicitly at the time the request is filed — not to try to obfuscate and bury a higher request for prior years' losses in an exaggerated contingency provision.** See VP/CW-T-1 at 33, VP/CW Initial Brief at 81-82, VP/CW Reply Brief at 30-31.

The Postal Service's memorandum quotes the Governors' statement that:

if net incomes were never achieved, because the revenue requirement including contingency exactly met the break-even point on average, then every year would have to be a rate case test year, in order for the Postal Service to break even, even in time of moderate inflation. Neither the Postal Service, its customers, nor the Commission would benefit from such endless rate litigation. [USPS Memo at 21.]

Although high sounding, this argument lacks merit. The Board of Governors controls the timing as to the filing of rate cases. It alone determined when to file Docket No. R2000-1, and

it will decide when to file the next rate case. Moreover, within reasonable parameters, the Postal Service — and no other party — selects the test year for the rate case. In this docket, the Postal Service had the option of using FY 2001 or 2002. It was the Board of Governors — and no one else — which approved the selection of FY 2001 as the test year. At the time the Board elected to file the case, it should have been apparent that (i) the test year would be one quarter over before any higher rates could be put into effect, and (ii) any reasonable application of the break-even principle to the proposed test year would necessarily limit the Board's policy options regarding the timing of future rate increases.

Had the Board of Governors opted to use FY 2002 as the test year, the Postal Service likely could have justified higher rate increases that would have given the Board greater flexibility regarding the timing of any subsequent rate case. In turn, however, the Postal Service might have had to take some heat for seeking higher rates in the context of a more forward test year. Instead, it opted for the more politically acceptable route: a 1-cent increase in the rate for the first ounce of First-Class Mail, with much self-congratulatory rhetoric about keeping the rate increase down to the least necessary amount.

Nowhere does the Postal Service explain or take responsibility for the fact that costs for many items are acknowledged to be increasing faster than inflation. Even with the Commission's reductions in the revenue requirement, on January 7, 2001, the rates for letter-shaped Standard A Regular and ECR (other than automated) Mail increased by 4.6 to 10.2 percent. Such increases, in light of the Postal Service's proclaimed success with automation of letter-shaped mail, are already far too high. The solution, to which the Board should devote arduous attention, and highest priority, is not even higher rates, but higher productivity.

The fact that the Postal Service must file for a rate increase every two years is a constant reminder of the Postal Service's inability to achieve productivity gains anywhere close to those of the general economy. Having failed on this score, the Postal Service attempts to minimize the political consequences by restraining the increase in the most visible rate, the first ounce of First-Class Mail. Then it seeks the best of both worlds, in asking the Commission to stand the concept and meaning of "break even" on its head by deliberately using the contingency provision to create a large slush fund for its discretionary use. Although the Act does not mandate that the Governors or the Postal Service be accountable to mailers, the Commission, or anyone else, the Act must not be read as giving them unlimited discretion to create whatever slush fund they desire, at the mailers' expense.

CONCLUSION

With respect to both the Postal Service's request for an additional \$200 million for a Field Reserve and an additional \$687 million for contingency funding, Val-Pak/Carol Wright submit that the Postal Service has again failed to provide any credible justification for the *Commission to increase the revenue requirement and recommend higher rates pursuant to its reconsideration of Docket No. R2000-1*. In brief, the Governors clearly view the Commission as playing no meaningful role in assessing the reasonableness of any revenue requirement underlying an omnibus rate case-in-chief.⁴ The Governors seek to instruct the Commission

⁴ Val-Pak/Carol Wright have previously explained the important role of the Commission in the statutory scheme in some detail which will not be repeated here. See Val-Pak/Carol Wright Initial Brief, at 75-76, and Val-Pak/Carol Wright Reply Brief, at 31-33.

that, as the Postal Service perceives itself to have met its *pro forma* requirement — the submission of conclusory testimony regarding the revenue requirement — the Commission's only role is to defer to the Governors' discretion (and perhaps fiddle with the Postal Service's distribution of revenue burden between the various postal products). The Governors seem to advance a new postal commandment — the Commission shalt not disregard or dispute testimony on the contingency by Postal Service witnesses. *See* Governors' Remand Decision, p. 2.

The Commission should not accede to this absurdly deferential role in its reconsideration of Docket No. R2000-1. Based on the reasons stated above, Val-Pak/Carol Wright herein encourage the Commission to continue to exercise its statutory role as a regulatory check on the Governors' demand for boundless discretion, and apply its well-considered standards of review (developed in prior dockets) to the Postal Service's proffered revenue requirement and contingency. It is submitted that a reasoned application of these standards to these issues will result in the affirmation of the analysis presented in the Opinion and Recommended Decision of November 13, 2000.

Respectfully submitted,

A handwritten signature in black ink, appearing to read 'William J. Olson', written over a horizontal line.

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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.

A handwritten signature in black ink, appearing to read 'William J. Olson', written over a horizontal line.

William J. Olson

January 12, 2001