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UNITED STATES OF AMERICA
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

COMMENTS
OF
THE OFFICE OF THE CONSUMER ADVOCATE
ON
REQUEST FOR FURTHER RECONSIDERATION

TED P. GERARDEN
DIRECTOR

EMMETT RAND COSTICH
SHELLEY S. DREIFUSS
KENNETH E. RICHARDSON
ATTORNEYS

March 19, 2001

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ON REQUEST FOR FURTHER RECONSIDERATION

The Office of the Consumer Advocate ("OCA"), pursuant to Order No. 1305,¹ hereby submits its comments on the Request of the United States Postal Service for further reconsideration of certain aspects of the "Opinion and Recommended Decision" issued in this Docket on November 13, 2000.

EXECUTIVE SUMMARY

The Commission has asked the participants to comment on (1) whether the Commission has the authority to recommend rates that would produce the higher revenues now requested by the Postal Service; (2) if so, whether the Commission should recommend such higher rates and revenues; and (3) again if so, how the rates should be developed.

The Commission does have the authority to recommend rates that generate revenues higher than those requested by the Postal Service, so long as the record

¹ "Notice of Submission of Request for Further Reconsideration and Order Establishing Procedures," issued March 9, 2001.

indicates that such revenues are necessary. In this case, however, there is no record support for such extraordinary relief. The Postal Service has chosen to rely on the existing record, eschewing the Commission's invitation to adduce new evidence that would support a change in rates and revenues from those already recommended. The Commission must not be swayed by the Postal Service's extra-record assertions—the only lawful result the Commission can reach is to recommend rates and revenues based on the evidentiary record.

While the Postal Service has not produced any new evidence, it does claim that its existing evidence on the appropriate level of the contingency is equal to that of the other participants. This is like equating *The Bobbsey Twins* to the *Brothers Karamasov*. The Commission recognized the tremendous qualitative difference between the Postal Service's testimony and that of the OCA and intervening parties concerning the contingency, and acted accordingly. That qualitative difference remains. Nor is the Postal Service convincing when it argues that the *Newsweek* case supports its view.² The Commission has followed the directions of the *Newsweek* court in reaching its decision in this case.

In short, review of the evidence confirms again the validity of the Commission's prior recommendation, which balanced a significant increase in test year costs with a reduction in the Postal Service's excessive contingency request. The facts still support this result. The request for further reconsideration should be denied.

² *Newsweek v. U.S. Postal Service*, 663 F. 2d 1186 (2d Cir. 1981); *aff'd on other grounds sub nom. Nat'l Assoc. of Greeting Card Publishers v. U.S. Postal Service*, 462 U.S. 410 (1983).

ARGUMENT

I. THE COMMISSION SHOULD NOT INCREASE THE REVENUE REQUIREMENT AS REQUESTED BY THE POSTAL SERVICE

The Commission has asked whether there are any statutory or procedural impediments to a Commission recommendation of rates that generate revenue in excess of the amount originally requested by the Postal Service. As is discussed below, no statutory provision explicitly restricts the Commission from recommending rates that provide revenues greater than those initially requested by the Postal Service, if the hearing record substantiates a need for such revenues. This is not the case in Docket No. R2000-1, where there are serious substantive and procedural impediments to increasing the revenue requirement as now requested by the Postal Service.

A. The Postal Reorganization Act Does Not Prohibit the Commission from Increasing the Revenue Requirement Beyond the Initial Request of the Postal Service

The starting point is the relevant statutory language. Nothing in the statute explicitly prohibits the Commission from recommending rates and fees that would yield revenues greater than those proposed by the Postal Service. The Commission is directed only to determine changes that are in the "public interest" and "in accordance with the policies of this title." 39 U.S.C. §3622(a). The overall policy is to insure that rates provide sufficient revenues so that total estimated income from specific sources equal "as nearly as practicable" total estimated costs. 39 U.S.C. §3621. It should be noted that in recommending rates, the Commission routinely recommends rates that

exceed the rates requested by the Postal Service for a particular service, thus resulting in revenues that exceed the filed estimates for that service.

In only one instance has the Commission recommended overall revenues that exceeded the request filed by the Postal Service. In Docket No. R84-1, the overall revenue resulting from the Commission's recommended rates exceeded the Postal Service's request by approximately \$400 million. A careful look at that case, however, shows that the Commission reached its conclusion based on unique facts that were developed in that record.³ This underscores the obvious—that the Commission cannot increase the Postal Service's requested revenues unless strong *record* evidence requires that result.

B. There Are Serious Substantive and Procedural Impediments To Increasing the Revenue Requirement at this Stage of the Proceeding

The Commission is now entertaining the Postal Service's second request for *reconsideration of the recommended decision in Docket No. R2000-1*. The sole remaining issue presented by the Postal Service concerns the proper application of the statutory provision for contingencies. Once again, however, the Postal Service offers neither *new evidence nor argument to support reconsideration*. Rather, the Postal Service asks the Commission to reverse its findings and holdings concerning the contingency provision based on the identical evidence and argument that the Postal Service presented last September. There is no basis in fact or law to support the Postal Service's request. Were the Commission to accede to the Postal Service's

³ PRC Op. R84-1, ¶¶ 0004-0005.

request, the recommended decision would be vulnerable to reversal by a reviewing court.

Postal rate proceedings must be conducted pursuant to the on-the-record hearing provisions of the Administrative Procedure Act. 39 U.S.C. §3624(a). The Commission has held the required hearing and has closed the evidentiary record. The Commission has twice found that “the evidentiary record, which was closed September 8, 2000, does not justify a more substantial increase in the Postal Service’s revenue requirement.”⁴ Despite the Commission’s explicit invitation to supplement the R2000-1 record,⁵ the Governors resolutely refuse to do so.⁶ Lacking any new evidence outside the four corners of the R2000-1 record, the Commission must follow the course configured by the same evidentiary guideposts that led to its earlier conclusion, *i.e.*, that a 1.5 percent contingency is the most reasonable alternative. The Commission cannot now reverse itself and credibly claim to be doing so on the basis of the same evidentiary record that twice led to the finding of a \$1,012-million contingency provision.

Despite their protestations to the contrary, the Governors and the Postal Service clearly want the Commission to reverse itself on the basis of extra-record information. For the Commission to do so, however, would violate both the statute and the Commission’s own rules of practice.

⁴ PRC Op. (Further Rec. Dec’n) R2000-1, ¶ 1003. See also PRC Op. R2000-1, ¶ 2171, in which the Commission expresses its lack of conviction in the Postal Service’s evidentiary presentation: “The Postal Service has not justified a contingency provision of this magnitude [*i.e.*, 2.5 percent] on the basis of revenue need in the test year.”

⁵ PRC Op. (Further Rec. Dec’n) R2000-1, ¶ 1005.

⁶ Dec’n of the Governors (March 5, 2001) at 4.

In their March 5 rejection of the Commission's Further Recommended Decision, the Governors stated (emphasis added):

The *current* situation clearly illustrates the justification for our conclusion. After over a year and a half of preparation and litigation of Docket No. R2000-1, we find ourselves, almost half way into the test year, operating under rates inadequate to meet the Postal Service's revenue needs. With every day that passes, our judgment as to the appropriate level of the Postal Service's revenue requirement, and specifically the reasonableness of its contingency provision, is vindicated.

* * * * *

Last month, the Chief Financial Officer told us that the Postal Service stands to lose between \$2 billion and \$3 billion this fiscal year, which is the rate case test year.

* * * * *

[A]s the Postal Service indicated in its memorandum on reconsideration, recent events confirm that the Postal Service's predictions on the record of the case were more reasonable and closer to what we *now* know is reality than were the determinations made by the Commission in its first Recommended Decision.

These references to current financial projections can hardly be accidental. But they are also extra-record. By persistently contaminating the decisional atmosphere with extra-record material, the Governors and the Postal Service have made it impossible for the Commission credibly to alter its on-the-record decision. The combination of two recommended decisions going against the Postal Service, coupled with the current drumbeat of extra-record statements made by the Postal Service, would render unbelievable any claim by the Commission that a reversal of its position on the amount of the contingency provision was based solely on existing record evidence.

By persistently thrusting extra-record material before the Commission, the Postal Service is asking the Commission to violate its own rules of practice. Rule 31(j) relates

to the Commission's taking official notice of facts. That rule provides that if the Commission desires to take official notice of a fact, it must allow participants the opportunity to show the contrary. For two reasons, it is impossible for participants to effectively rebut the Postal Service's claims of large impending losses. First, the evidentiary record is closed and no party—most emphatically not the Postal Service—has asked that it be reopened. Short of resorting to the same tactics as the Postal Service, participants have no way of presenting the Commission with contrary facts. Second, the participants have little meaningful access to the Postal Service's accounting records or financial data. Thus, the participants have no independent way to evaluate recent claims of a looming \$2-3 billion loss, and no direct way to show how such claims might be erroneous or misleading.

If the Commission were to decide to reopen the record to consider the new information suggested by the Postal Service in support of adjusting the contingency allowance, the Commission would also have to consider other related matters, such as the Governors' announced \$1 billion reduction in planned test year investment expenditures. The \$1 billion reduction in investment expenses appears to be a certainty that essentially eliminates \$1 billion right off the top of the Postal Service's revenue requirement without significantly impacting revenues or other test year costs. On the other hand, extra-record claims of potential reductions in revenues due to potential volume declines, and extra-record claims of potential cost increases that may lead to billions of dollars of losses in the test year, may not be demonstrable. In short, whether the Postal Service will incur any newly anticipated test year losses without an upward revision of its rates requires additional study and the opportunity for a hearing

to explore the situation.⁷ It is telling that, despite the Commission's invitation to support reconsideration with new evidence, the Postal Service deliberately chose not to do so.

In effect, the Postal Service is suggesting that, since its request in this case, and even since its update of the record in this case during the summer of 2000, management has again recalculated its revenue requirement. It now believes test year operating expenses will exceed revenues by the allowed \$1 billion contingency (1.5 percent of the revenue requirement), the \$0.312 billion allowance for RPYL, the \$1 billion in planned investment being eliminated, plus an additional net loss of \$2 to \$3 billion. Even allowing for the \$0.8 billion that the Postal Service claims in this record will not be recovered by the new rates, that would be a turnaround of the financial fortunes for the Postal Service of \$3.5 to \$4.5 billion in the six- to nine-month period since the record in this case on updated costs was developed. This possibility exceeds the bounds of credibility and cannot be a basis for the Commission, without further evidence and hearings, to adjust the revenue requirement already determined twice on this record by the Commission.

II. THE COMMISSION SHOULD NOT RECOMMEND HIGHER RATES

The Governors' most recent decision is devoid of any new arguments, reasoning, or insights, a necessary pre-condition for the Commission to depart from its earlier adherence to the propriety of a 1.5 percent contingency. Following another

⁷ A reopened record showing that the Postal Service now plans to spend \$1 billion less for investment in the test year than estimated in the current record would provide precisely the hard evidentiary data warranting a downward adjustment in the revenue requirement that was envisioned necessary by the court in *United Parcel Service* to demonstrate that planned investment expenditures would not occur. *United Parcel Service v. U.S. Postal Service*, 184 F. 3d 827, 834-36 (D.C. Cir. 1999).

careful re-examination of the unchanged record, the Commission can do no more than reach the same conclusion it has reached twice before. As the Commission has repeatedly concluded, the Postal Service inadequately defended its proposal to increase the contingency from one to 2.5 percent in this proceeding. In sharp contrast, the OCA, the Consortium, and other parties presented extensive, thorough, and in-depth analyses of the Postal Service's financial condition and the state of the economy.

A. The Postal Service's Arguments Are Disingenuous

In their decision, the Governors make only a perfunctory effort to persuade the Commission to overturn its earlier findings. However, two serious misrepresentations are made which cannot be allowed to stand unanswered.

First, the Governors argue that Postal Service testimony and participant testimony were essentially equivalent, but merely reached different conclusions. Governors' Dec'n at 3-4. This is a gross distortion of the record. Witness Tayman, the Postal Service witness charged with the responsibility to present and support the proposed 2.5 percent contingency, spent a mere 3 ½ pages explaining his rationale for increasing the contingency 150 percent above its Docket No. R97-1 level. Witnesses Burns, Rosenberg, and Buc, in sharp contrast, devoted scores of pages of testimony and analysis to the subject of a properly sized contingency. The Commission accurately describes this aggregation of participant testimony as "voluminous." PRC Op. R2000-1, ¶ 2151.

Second, the Governors attempt to draw a parallel between the actions of the Commission that were the subject of the *Newsweek* case⁸ and the process followed in R2000-1. Further Rec. Dec'n at 5. This is a flawed analogy that collapses under scrutiny. In *Newsweek*, the Second Circuit Court of Appeals characterized the Commission's elimination of \$449 million of prior year loss recovery as "disciplinary" and a "divisive bureaucratic tactic." 663 F. 2d at 1204. The PRC was said to have made an "unexplained departure from past decisions." *Id.* The Court articulated the standard for reviewing the Commission's exercise of authority: the Commission must not make arbitrary adjustments, particularly not for the purpose of stimulating more frequent rate filings; and the Commission should articulate its reasons for any modifications. *Id.* at 1205.

In its initial opinion in R2000-1 and in its further decision, the Commission has fully satisfied these injunctions. Over several pages in the opinion, the Commission carefully describes the process it followed to evaluate evidence presented on the level of the contingency. The Commission first establishes that the "reasonableness" standard of 39 U.S.C. § 3621 is an objective criterion that is investigated by "receiving and assessing the probative value of testimony proffered by participants" PRC Op. (Further Rec. Dec'n), ¶ 2082.

The Postal Service, which has the burden of proof to establish the superiority of its proposal, led off with the testimony of witness Tayman. As the Commission found, the "Postal Service evidence . . . was effectively challenged by several witnesses." *Id.*,

⁸ See n.2, *supra*.

¶ 2084. The Commission weighed the Postal Service's scanty evidence against the "voluminous presentations" (PRC Op. R2000-1, ¶ 2151) made by "numerous other participants." Further Rec. Dec'n, ¶ 2085. Finally, the Commission made an independent finding on the most reasonable level for a contingency provision "in the circumstances of this case as documented in the record." *Id.* Participant evidence that was "unprecedented in extent and detail" (*Id.*, ¶ 2087) and that was of superior "volume and probative value" (*Id.*, ¶ 2091) convinced the Commission that a 2.5 percent contingency provision was too high. An additional crucial consideration in R2000-1 was that "the burden from the contingency is larger than the burden from documented increases in attributable costs." *Id.*, ¶ 2088.

The Postal Service's presentation was cursory and insubstantial by comparison. Participants convincingly criticized the Postal Service's "failure to take a more systematic, quantitative approach to developing the contingency provision." *Id.*, ¶ 2092. OCA witness Burns' testimony demonstrated that a "systematic approach to estimating the need for contingency reserves" is clearly feasible since it is done regularly in the insurance and other industries. *Id.* OCA witness Rosenberg, in two analyses he submitted for consideration, was "particularly convincing." *Id.* Consortium witness Buc persuaded the Commission that witness Tayman should not have repudiated the results of the *pro forma* variance analysis that he appended to his testimony. *Id.*⁹

⁹ Witness Tayman clings to the unscientific view that it would be "irresponsible and illogical" to expect that historical variance analysis would be useful in predicting the level of unforeseen occurrences in the test year. USPS-T-9 at 45.

B. Given the Updated Cost Estimates, a 2.5 Percent Contingency Cannot Be Reconciled with the Record

The Postal Service has thrice asked the Commission to do the irrational—apply the same 2.5 percent contingency provision proposed at the outset of the case to the updated cost estimates furnished by the Postal Service¹⁰ (albeit reluctantly) in response to Order No. 1294.¹¹ The urged mechanical application of the same percentage contingency provision initially proposed would be in serious conflict with the evidence of record in R2000-1 and findings the Commission made repeatedly in its initial decision *and further recommended decision*. Having determined as a legal matter that the purpose of the contingency is essentially twofold, *i.e.*, to protect against (1) misestimates of future financial results and (2) unforeseeable, unavoidable events that may cause financial harm,¹² the Commission then makes the finding that the “use of updated costs does reduce the magnitude of likely forecasting error.”¹³

The cost estimates adopted from witness Patelunas’ supplemental testimony, to which the contingency is applied, are substantially higher than estimates initially presented by witness Tayman in January 2000, when the Request was filed. In January 2000, witness Tayman was forecasting TYAR costs of \$67.1906 billion. Six months later, in its response to Order No. 1294, the “sum total of revenue requirement

¹⁰ USPS-RT-1 at 30 (Rebuttal testimony of witness Strasser), Dec’n of the Governors (issued December 4, 2000) at 12, and Dec’n of the Governors (issued March 5, 2001) at 3, “We ask that the Commission reconsider this determination and restore the contingency based on the updated level of costs that it has adopted.”

¹¹ “Order on the Use of FY 1999 Data,” issued May 26, 2000.

¹² Further Rec. Dec’n R2000-1, ¶ 2074.

¹³ *Id.*, ¶ 2095.

changes” made by the Postal Service added \$617.5 million to the revenue requirement initially filed.¹⁴ This \$617.5 million increase resulted from “the latest available actual results and forecasts in updating test year costs, and was accepted by the Commission.”¹⁵

The updates included the use of revised cost level change factors, among them (1) the substitution of a full ECI for the original assumption of ECI minus one, (2) the use of a more recent, higher CPI factor to calculate the COLA of postal employees, (3) more recent, higher transportation indices, (4) more recent, higher fuel costs, and (5) higher “other program” costs. *Id.* These updated, higher figures undoubtedly reduce the risk of misestimation; perforce, the 2.5 percent contingency initially proposed must be reduced accordingly.

The Postal Service’s own economic expert conceded as much. Witness Zarnowitz testified that shortening the time for estimating costs reduces the uncertainty of the estimates. Tr. 41/18234. Witness Strasser, moreover, conceded that updating ECI costs gave a more “realistic” picture of labor costs in the test year, that updating COLA payment information made that element of the cost update more certain and that, in general, more recent forecasts are more “accurate.” Tr. 46A/20275-77 and 20361.

¹⁴ See PRC Op. R2000-1, App. K, p. 2.

¹⁵ Further Rec. Dec’n, ¶ 2095.

The implication of the Governors that an unreduced 2.5 percent contingency could be compatible with the record developed in R2000-1 is simply wrong. There is no logical or rational application of the record that could permit such a result.

III. IF HIGHER RATES ARE RECOMMENDED, THEY SHOULD BE DEVELOPED WITHOUT EXACERBATING THE EXISTING BURDEN ON FIRST-CLASS MAIL

As just discussed, it is the position of the OCA that consideration of higher rates is inappropriate at this time. The OCA also has serious reservations about the fairness of any attempt to re-fashion rates based on a revenue requirement nearly one billion dollars higher than the revenue requirement that underlies the current constellation of rates now in place. The R2000-1 record is devoid of any evidence on a proper set of rates that would equitably allocate the additional cost burden that the Governors would now have the Commission impose.

If, contrary to the exhortations of the OCA and many of the other participants, the Commission does decide to distribute an additional billion dollars among the postal classes and services, then the most equitable way to do so would be first, to evaluate the rates currently in place to be certain that all of the attributable costs of each subclass are fully recovered by the subclass rates, and second, to increase the cost coverage of each subclass in proportion to the cost coverage recommended by the Commission in its initial decision. Either the Commission's R2000-1 cost coverage index or the markup index could serve as a guide.

In no event should the Commission attempt to shift the recovery of a billion additional dollars to First-Class. Under the current rate schedule, First-Class letters and cards have a combined cost coverage of 177.1 percent, nearly 20 points higher than

the systemwide average of 158.7 percent. Moreover, First-Class letters and cards bear the burden of recovering 63 percent of institutional costs. In light of the excessive contributions already made by First-Class Mail to institutional cost recovery, First-Class—especially the first ounce of First-Class—should be spared any increase. If the Commission does raise rates in First-Class, the proportional approach described above should be viewed as the maximum level of increase.

CONCLUSION

For all of the foregoing reasons, the OCA urges the Commission to deny the Governors' request for further reconsideration of the recommended rates in this proceeding.

Respectfully submitted,

OFFICE OF THE CONSUMER ADVOCATE



Ted P. Gerarden
Director


Emmett Rand Costich
Shelley S. Dreifuss
Kenneth E. Richardson
Attorneys

1333 H Street, N.W.
Washington, D.C. 20268-0001
202) 789-6830; Fax (202) 789-6819

March 19, 2001

CERTIFICATE OF SERVICE

I hereby certify that I have this date served the foregoing document upon all participants of record in this proceeding in accordance with Section 12 of the Rules of Practice.

A handwritten signature in black ink, reading "Stephanie S. Wallace". The signature is written in a cursive style with a long, sweeping underline.

Stephanie S. Wallace

Washington, D.C. 20268-0001
March 19, 2001