

Before The
POSTAL RATE COMMISSION
WASHINGTON, D.C. 20268-0001

Postal Rate and Fee Changes, 2005)

Docket No. R2005-1

OFFICE OF THE CONSUMER ADVOCATE
OPPOSITION TO UNITED STATES POSTAL SERVICE
REQUEST FOR EXPEDITION AND EARLY CONSIDERATION OF
PROCEDURES FACILITATING SETTLEMENT EFFORTS
(April 29, 2005)

The Office of the Consumer Advocate (“OCA”) hereby responds in opposition to the request of the United States Postal Service (“Postal Service”) for expedition and early consideration of procedures facilitating settlement efforts (“Request”)¹ filed together with the rate request in this proceeding on April 8, 2005. Comments on the need for expedition and procedures for facilitating settlement of this case are due no later than May 2, 2005.²

Owing to the Postal Service’s current sound financial condition, which was precipitated, in large part, by being relieved of annual CSRS payments for a period of three years, OCA opposes any shortening of the customary discovery period of 2 ½ months. As for other procedural dates proposed by the Postal Service, it is too early to determine whether subsequent procedural stages can

¹ “United States Postal Service Request for Expedition and Early Consideration of Procedures Facilitating Settlement Efforts,” April 8, 2005.

² “Notice and Order on Postal Service Request for Changes in Domestic Postage Rates and Fees,” ordering para. 8, April 12, 2005.

be accelerated or truncated. The key fact that is virtually buried in the instant filing is that if the Commission approves rate increases that produce a \$3.1 billion infusion of revenues in FY2006, the statutory breakeven requirement of the Postal Reorganization Act will be violated. In its filing, the Postal Service reveals that it is likely to end FY2005 with a cumulative net positive income of \$2.54 billion. These are retained earnings that can be used to pay for most of the \$3.1 billion escrow payment currently required to be made by the end of FY2006.

Even with a \$3.1 billion escrow payment into the U.S. Treasury by the end of FY2006, the Postal Service would be faced with a relatively small deficit of \$501 million. In order to break even in the test year of this proceeding – FY2006 – the Postal Service need only raise rates a little over 1%, at most, to erase the \$501 million deficit.³ The Postal Service's proposed rate increase of 5.4% produces a huge surplus of \$2.65 billion – a far cry from the zero (or breakeven) condition specified by Congress in section 3621 of title 39.

The effect of the Postal Service's request for an across-the-board 5.4% increase in rates that produces a \$2.65 billion surplus is, effectively, to ask that mailers pay in advance for potential deficit spending that may arise in years that follow the test year. This is a radical proposal that must be clearly articulated

³ An across-the-board rate increase that raises \$501 million to achieve breakeven is calculated as follows: implementation of an across-the board increase of 5.4% in Quarter 2, FY2006, produces approximately \$2.33 billion of new revenues. $\$501 \text{ million} \div \$2.33 \text{ billion} = 21.5\%$. Thus, the Postal Service needs 21.5% of the new revenues it is requesting in the current case. One may apply the 21.5% to the across-the-board figure of 5.4% to give a rough approximation of the across-the-board increase that is really necessary to achieve breakeven: $0.215 \times 5.4\% = 1.16\%$. In fact, the increase should be even less than 1.16% because the volume impact of a relatively small rate increase of 1.16% is a small fraction of the dampening effect of a 5.4% increase.

and addressed by interested mailers. Even apart from the question of whether such a proposal is lawful under 39 U.S.C. §3621, mailers should be given an opportunity early in the proceeding to express whether they would willingly pay in advance for expenses not yet incurred. As a representative of the “general public,” and consumers in particular, OCA believes that consumer mailers do not wish to pay in advance. Rather, they would prefer to have their rates increase only so much as costs warrant.

If there is one thing that is wholly unwarranted in light of the surplus being sought by the Postal Service, it is an accelerated procedural schedule in the instant proceeding. If the Commission does approve an across-the-board rate increase of 5.4%, in order to break even in the test year, the Postal Service should implement the increased rates no earlier than August 2006. A Commission decision issued in 10 months, in February 2006, and allowing time for implementation, would give the Postal Service 3 months longer than is warranted to achieve a 2006 breakeven condition.

It is possible that the current rate case can be completed in less than 10 months if few (or no) parties choose to litigate the issues presented or implicit in the filing. Under that circumstance, the schedule would contract naturally because there would be few or no requests to cross-examine Postal Service witnesses or file participant direct cases. Without the filing of participant direct cases, of course the rebuttal stage would be eliminated. Even if many participants choose to settle this case with the Postal Service, the Commission should not prevent other participants from using discovery to attain a full

understanding of the evidence filed by the Postal Service. In particular, OCA asks for a traditional period of time for discovery since the Postal Service has filed an important new cost methodology to estimate the volume variability of city carrier costs and a cost methodology for the volume variability of mail processing costs that incorporates elements used previously by Postal Service witness Bozzo and some of those recommended by OCA's consultant, Professor Mark Roberts.

I. The Need for Expedition Is Not Demonstrated

The Postal Service has not demonstrated the need for the expedition it requests. The OCA favors expeditious procedures where the situation warrants expedition and where the interests of the parties are protected so as to assure a full opportunity to explore the facts and issues underlying a particular request and to allow opportunity for a full and fair airing of the facts. On the face of its filing the Postal Service has not demonstrated the need for expedition.

First, as usual, the Postal Service has delayed its filing until beyond the last minute to a date where no matter how quickly everyone responds to its request (the parties, the witnesses, and the Commission), the Postal Service cannot increase rates soon enough for it to receive the revenues it claims are necessary for FY2006.

The Postal Service now demands expedition so it may implement the new rates in January of 2006. It points out that if a recommended decision takes ten months to issue (about February 8, 2006), then implementation would be delayed

about three months, causing it to reduce the FY2006 revenues by roughly \$1 billion. (Request at 3-4.) As always, the Postal Service has had control over the date of its filing and very well could have filed sooner. Rather, it has placed all concerned in a position where even the 10 months that Congress permitted for Commission action on a rate proceeding is not soon enough for the Postal Service.

More significantly, the true financial picture is not nearly as bleak as the Postal Service claims. The demand of the Postal Service for an immediate settlement and infusion of postage increases to avoid the revenue shortfall described by witness Potter, USPS-T-1, arising from the \$3.1 billion payment long mandated by Public Law 108-18 overstates the problem. The rate filing carefully demonstrates that without any rate increase next year Postal Service revenue will barely match its costs and will be short by just over \$3 billion. But, the Postal Service has built up in the last three years since the current rates became effective June 30, 2002, a reserve war chest of retained earnings—that is, past profits have accumulated in an account conceptually similar to a retained earnings account.

It is well established that §3621 of the Postal Reorganization Act requires total estimated income (plus appropriations) to equal as nearly as practicable total estimated costs—that is—breakeven. Because costs and revenues fluctuate from year to year between rate cases, year to year breakeven is not expected to be maintained, but when the Postal Service does file for a rate

increase, the books should be evened-up unless there is a very good policy reason consistent with the Postal Reorganization Act for not doing so.

It has been long settled, especially since the Commission's Opinion in Docket No. R76-1,⁴ that the statutory breakeven requirement applies to long-run cumulative losses. Thus, when the retained earnings were negative, steps were taken to true-up that account so that, over time, the Postal Service would break even. For instance, when the cumulative losses grew large, the Commission established a method to work off the shortfall by adding one-ninth of the total shortfall to the revenue requirement. Otherwise, the impact on rates (rate shock) would have been prohibitively onerous. That is not the case here. Simply delaying the rate increase or reducing the percentage of the rate increase will quickly work off the accumulated net income without rate shock.

In fact, based upon the testimony and exhibits of the Postal Service's own financial expert witness Tayman, the Postal Service is in the midst of a financial windfall of profits that have accumulated over the last two fiscal years and will continue to accumulate through the end of this fiscal year, 2005. For the first time in its history, from the commencement of operations as the United States Postal Service on July 1, 1971, the Postal Service does not have a cumulative net loss. (Tayman, Exhibit USPS 6I.) Earnings of over \$3 billion in each of the fiscal years 2003 and 2004 have eliminated past losses and resulted in a build-up of retained earnings.

⁴ See Opinion and Recommended Decision, Docket No. R87-1 at 17, that discusses Docket No. R76-1.

By the end of this fiscal year, FY2005, with projected earnings of \$1.64 billion five months away, the total cumulative net income (retained earnings) as projected will be, in millions, \$2,540.712 (i.e. over \$2.5 billion). And this number may be low, inasmuch as the earnings for the year to date have exceeded budget projections. For instance, at the Board of Governors meeting in February of 2006, the Postal Service's chief financial officer, Mr. Strasser, reported that the first quarter profits exceeded budget and that the second quarter earnings were likely to be positive, whereas the budget projected a \$200 million loss.⁵

While profits of \$500 million in excess of those projected are not currently anticipated, the fiscal year still has several months to run and it is not inconceivable that the cumulative net income of the Postal Service (retained earnings) will increase from the projected \$2.541 billion to as much as \$3.1 billion by the end of this fiscal year, 2005.

In this case, the Postal Service does not need \$3.1 billion for FY2006 to maintain a cumulative breakeven posture.⁶ Under current rates and without any rate increase, according to the filing, the large accumulation of profits will fall to only a \$501 million deficit by the end of FY2006. The proposed rates could be implemented late in the fourth quarter of FY2006, and produce the statutory breakeven condition. Thus, at the end of FY2006, the retained earnings would

⁵ Postal News, United States Postal Service press release, February 17, 2005 and oral report of Richard Strasser, Postal Service Board of Governors meeting, February 17, 2005.

⁶ Nor does the Postal Service even need in FY2006 the anticipated \$2.3 billion it will gain if these rates become effective on January 1, 2006. Because the rates will not become effective until the start of the second quarter of FY2006, the Postal Service says it will lose about \$800 million of income in that year. Tayman, USPS-T-6, at 54.

be reduced to approximately zero (breakeven), thus meeting the expressed intent of Congress in the Postal Reorganization Act. Where, as now, there are positive retained earnings, we submit that the Postal Reorganization Act requires the Commission to recommend rates that move toward breakeven. It does not matter that for all of FY2006, the Postal Service may have a loss of \$2.5 billion because it will only be truing up the revenues and costs which have recently been unequal as demonstrated by the profits for the previous three years.⁷

The Postal Service has indicated in its filing that this rate case is intended only to meet the immediate needs of FY2006 and that it intends to file a separate case in the “near future.”⁸ However, since the need for a rate increase to meet a shortfall in FY2006 appears minimal, the Commission might also consider whether the entire proceeding may not be necessary at this time and the retirement deposit expense might be reconsidered in the next soon to be filed omnibus rate case seeking an increase of rates in FY2007.

OCA recognizes that if rates are not increased in this docket by an amount of \$3.1 billion on an annual basis, the Postal Service may need to increase its rates in FY2007 to meet the requirement to deposit the required retirement funds into the U.S. Treasury. Nevertheless, there are many variables that might

⁷ The Postal Service may be required to borrow funds to pay some of the \$3.1 billion retirement amount, but its total debt would still be extremely low; projected as only \$1 billion by the end of FY2005, down from over \$11 billion as recently as the end of FY2002. Tayman, USPS-T-6, Table 10 at page 15.

⁸ See OCA/USPS-T1-2c, response of witness Potter that an omnibus rate case will likely be filed in calendar year 2006. See also, Letter from Daniel J. Foucheaux, Jr., Chief Counsel, Ratemaking, to Parties of Record, Docket No. 2001-1, April 4, 2005, Attachment to Request.

intervene between now and the beginning or even during FY2006 to reduce the need for additional revenue in FY2007. For instance, the earnings this year may exceed significantly the projected \$1.6 billion income and next year may bring additional income not now anticipated. The earnings in FY2006 may be very nearly where they are this year. Note that the test year estimates indicate the Postal Service will have an earnings reduction between FY2005 and FY2006 of \$1.6 billion at a time when the economy is doing well and productivity gains have exceeded expectations.⁹ Also, Congress may act after January 2006 to reduce the escrow payment.

Thus, since the requested rate increase in January 2006 would produce excess revenues that would maintain a cumulative income and thus probably violate the breakeven directive in the statute, there is no need to hasten a decision and prematurely increase rates in this docket. As the prepared testimony demonstrates, if the rate increase is granted, the test year after rates net equity position will be, in millions, \$5,686.659. (Tayman-T1, Table 63, page 54.)¹⁰ When the approximately \$3 billion¹⁰ of cash infusion provided by Congress over the years to mitigate past losses is subtracted from the equity position, the cumulative net earnings at the end of FY2006 will apparently still be, in millions,

⁹ See the comments of Chief Financial Officer Richard Strasser at the February Board of Governors meeting, note 5, supra.

¹⁰ Our contention here relates only to the issue of the cumulative net income. A further question may be in issue regarding the propriety of permitting equity build-up as a result of Congressional appropriations, inasmuch as §3621 of the Postal Reorganization Act includes appropriations along with total estimated income in calculating the amount of revenues that must equal as nearly as practicable total estimated costs.

\$2,652.735.¹¹ Thus, the statutory breakeven policy will have been ignored in favor of a premature rate increase.

OCA's position is that the filing on its face does not demonstrate a need to increase rates as soon as the Postal Service requests, early FY2006, when past and continuing profits have placed the Postal Service in the unusual and enviable position of having positive retained earnings. Those amounts can be utilized to delay the majority of the postage increase by forestalling the implementation of the increase until well into the fourth quarter of the year, if at all.

OCA suggests that because this is an unusual situation regarding the accumulated earnings of the Postal Service and in view of the Commission's recent Notice of Inquiry¹² in this proceeding directed to another legal question surrounding registered mail, the Commission might consider issuing a similar Notice of Inquiry with regard to whether it would be consistent with the Postal Reorganization Act to recommend rates that will knowingly increase or maintain accumulated profits. To that end, the Commission might further consider issuing a declaratory order on the matter during the course of the proceeding. Normally, a question of law or policy might await the briefing stage, but where, as here, the Postal Service is seeking a quick settlement of the issues, consideration of the permissible timing or percentage of the rate increase would be relevant to settlement negotiations.

¹¹ This is calculated from the test year after rates equity of \$5,686.659 (Tayman-USPS-T1 at 54, Table 63) reduced by \$3,033.924 (difference of Equity and Cumulative Net Income columns for FY 2005 and earlier, Exhibit USPS-6I.)

¹² "Notice of Inquiry No. 1 Concerning Registered Mail," April 16, 2005.

II. The Discovery Period Should Be Longer and the Procedural Dates are Premature

The Postal Service's request for expedition should be denied insofar as it shortens the normally available time of two and a half months from the date of filing for full discovery of the Postal Service's case. That is, OCA believes discovery directed to the Postal Service should be permitted until July 1, 2005.

In this proceeding, the Postal Service has filed two major changes in its methodologies. They are related to carrier delivery costs and mail processing costs. The OCA previously sought to obtain some back-up materials necessary to review these new methodologies months ago, but the information was not forthcoming. Only recently, since the rate filing has the Postal Service made some of that information available. If this material had been available sooner, it is likely the time needed for full discovery could have been shortened.

The Postal Service's proposed schedule attached to its request also contains an unrealistic date of June 17 for the participants to provide a "Notice of Opposition to Settlement Agreement." It is apparent that no formal settlement discussions will even begin until sometime around the prehearing conference on May 5. It belies logic to think that, unless all of the parties immediately accept the filing as proposed, there will be time for the normal give and take of negotiations to occur in order to reach before June 17 a reasonable accommodation among all of the interested participants.

Although the Postal Service takes great pains to describe the efforts it has taken to discuss settlement with individual participants, the OCA has had no discussions with the Postal Service regarding settlement. Only a brief

informational conference was offered by the Postal Service just prior to the rate filing. While the Postal Service seems to suggest there is a groundswell of support for a quick settlement (“substantial support for settlement already exists in the mailing community,” Request at 7), OCA has seen no evidence of settlement discussions nor have we been party to any negotiations. Thus, we are concerned that the so-called settlement talks have been nothing more than an informational effort to leave the impression of settlement (“momentum toward settlement has already been developed” Request at 8.), when, indeed, the whole picture has not been seen by the parties, particularly any specific adjustments that might be agreed to between individual parties and the Postal Service.

As for the proposed procedural dates beyond the date for a notice of opposition to a settlement agreement, it is premature as the need for hearings will not be known until near or after the end of discovery and the success of the settlement negotiations has been better established.

Respectfully submitted,

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