

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

**POSTAL RATE AND FEE CHANGES }
PURSUANT TO PUBLIC LAW 108-18 }**

DOCKET No. R2005-1

INITIAL BRIEF OF MAIL ORDER ASSOCIATION OF AMERICA

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STATEMENT OF THE CASE AND STATEMENT OF POSITION

The issues in this case are: (1) whether the United States Postal Service has properly exercised its discretion to request a rate increase in order to satisfy the escrow payment imposed by Public Law (P.L.) 108-18, and (2) whether the proposal to recover the amounts necessary to meet that institutional cost by an across-the-board rate increase is reasonable and in accord with the provisions of the Postal Reorganization Act (the “Act”). The Mail Order Association of America (“MOAA”) together with thirty four other parties (representing all but a small fraction of total mail) have entered into a Stipulation and Agreement (“Agreement”) accepting the Service’s proposal in complete settlement of this proceeding, as filed with the Commission on September 23, 2005. Only one party (Valpak) has filed testimony in opposition to the Postal Service’s request, testimony that has been shown to be without substance by the rebuttal testimony filed by both the Postal Service and Advo.

It is the position of MOAA that, as a policy choice that is within the discretion of the Governors, the Commission should accept the Agreement that has been proffered by the Postal Service and the thirty five mailer parties, a choice which would permit the Postal Service to recover the phantom costs represented by the escrow payment in the least disruptive fashion possible. Although MOAA has been and continues to be concerned about the rate levels for Standard Mail ECR, we consider the across-the-board proposal reasonable. Further, the Service has filed substantial evidence to support the request and establish that it complies with the pricing factors of the Act.

DISCUSSION

I. INTRODUCTION

MOAA is a signatory to the Agreement that seeks to have the Commission accept the across-the-board 5.4 percent rate increase requested by the Postal Service. MOAA submits that it is beyond reasonable dispute that the testimony that has been filed by the Postal Service provides “substantial evidence of record” in support of the proposed rates and fees and is therefore in accord with the requirements 39 U.S.C. § 3661. Further, the Agreement should be accepted by the Commission as a matter of policy. MOAA agrees with Postmaster General Potter (the “PMG”) that the requested across-the-board increase represents “the most reasonable, practical and effective way to meet a currently unavoidable financial obligation in Fiscal Year 2006.” USPS-T-1 at 2.

As the PMG’s testimony further explains, the rate increase is designed to meet the obligation imposed by P.L. 108-18 requiring the Postal Service to deposit into “escrow” approximately \$3.1 billion in Fiscal Year 2006. The PMG has recognized that the rate increase will make it more difficult for the Postal Service to meet the serious challenges it faces. As he stated, raising rates “prematurely for any reason will not help us meet them, and will burden our customers and the economy.” USPS-T-1 at 2. MOAA joins the PMG in lamenting the fact that current law imposes on the Postal Service an obligation to pay into escrow amounts of money that are unrelated to its operating costs. A solution to the requirement that escrow funds be paid, however, is wholly within the hands of the United States Congress and the President of the United States. As tempting as it is to rail against that reality, there is nothing that the Postal Service, the mailers, or this Commission can do about it.

The only issue therefore is whether what the Postal Service has proposed is a reasonable solution to its imposed obligation to make the escrow payments. MOAA submits that the request is reasonable. The fact that only a single party has submitted testimony questioning the USPS proposal is in itself indicative of the reasonableness of the request. Further support is offered by the fact that the Agreement has been signed by parties representing all but a small portion of the mail.

II. THE ACROSS-THE-BOARD INCREASE PROPOSED BY THE POSTAL SERVICE IS THE BEST WAY TO MEET THE REQUIREMENTS OF PUBLIC LAW 108-18.

PMG Potter has explained that P.L. 108-18 requires that the amount to be paid into escrow be deemed an operating expense of the Postal Service, despite the fact that the amount is wholly unrelated to actual operating costs. The law provides no indication of how this burden should be allocated among mailers, nor is there a basis for determining on a causal basis which type of mail is responsible for the costs. No type of mail “caused” the cost. Therefore, the phantom costs must be met by all mailers. The PMG has described the Service’s approach as a “simple, uniform solution”. USPS-T-1at 5. MOAA concurs.

MOAA supports the Agreement despite the fact that the Standard Mail ECR subclass under the proposed Agreement would have a cost coverage of 244 percent, the highest cost coverage of any class or subclass of mail. MOAA is obviously concerned about this cost coverage. At the same time, however, MOAA recognizes that the high cost coverage has not been occasioned by the need for the Postal Service to recover the escrow obligation, but rather by the underlying cost and revenue relationships of the various classes of mail. Therefore, given the PMG’s recognition of the need to address rate relationships in a future proceeding, MOAA concurs in the Postal Service’s proposal to recover the needed revenues by an across-the-board rate increase.

III. THE POSTAL SERVICE’S REQUESTED RATE INCREASE IS IN CONFORMITY WITH THE REQUIREMENTS OF THE POSTAL REORGANIZATION ACT AND THE SERVICE’S REBUTTAL TESTIMONY DEMONSTRATES THAT VALPAK’S CONTRARY ARGUMENTS HAVE NO VALIDITY

A) THE BOARD’S AUTHORITY

The testimony filed by the Postal Service in support of its request provides ample support for its position that the request is in conformity with the requirements of the Postal Reorganization Act. The only testimony to dispute that proposition was presented by Valpak witness Mitchell. The testimony of USPS witness Kiefer, USPS-RT-1, demonstrates that witness Mitchell has provided no basis for a rejection of the Postal Service’s rate proposal. The USPS Board of Governors has the authority to determine that it should seek a rate increase to fund the escrow rather than, *e.g.* borrowing the funds to meet that obligation. USPS-RT-1 at 6, 7. Further, the Postal Service has correctly determined that the escrow funds are not volume variable and therefore represent

“institutional” costs that should be assigned rather than attributed. *Id.* at 10. In sum, the Service’s request is a proper one under the requirements of the Act. As stated by witness Kiefer:

It is fully within the prerogatives of the Board, in the exercise of its statutory authority, to manage the Postal Service and to determine when, how and for what purposes to request recommendations on changes in rates and fees.

Id. at 13.

B) SETTLEMENT PROCEEDINGS

Valpak witness Mitchell also alleges that an attempt to settle this proceeding violates the Act, a peculiar proposition given the history of settlements before this Commission. Witness Kiefer’s testimony disposes of the claim. The Act and the Commission’s rules “support the conclusion that appropriate ratemaking favors, rather than discourages, settlement, as long as the proceeding has been fairly conducted and the Commission has taken into account all relevant considerations in making its recommendations.” *Id.* at 17.

C) ACROSS-THE-BOARD INCREASES

Contrary to Valpak’s contention, witness Kiefer’s testimony conclusively demonstrates that an across-the-board rate increase is permitted by the Act and supported by the Postal Service’s testimony. *Id.* at 19-26.

D) ECR RATE LEVELS

Valpak witness Mitchell has observed with respect to Standard Mail rates that “progress is occurring slowly” and should be a “cause for concern.” Tr. 9/5300. MOAA agrees with that observation. Achieving more reasonable rates for Standard Mail ECR is an important goal. It is imperative that the rates for Standard Mail ECR be adjusted to properly reflect costs and the pricing factors of the Act. Again, however, MOAA submits that the Postal Service in this proceeding has adopted a reasonable approach that will best serve all mailers by allowing the Postal Service to meet the escrow payment in a way that will neither favor, nor unduly burden, any particular type of mail or any particular mailer.

Further, no Valpak witness had provided a basis for a modification of the rates recommended by the Postal Service. It is clear, for example, that witness Mitchell’s suggestion that

current ECR rates be frozen could be implemented only by increasing other rates, but no proposal for such an increase has been advanced.

E) DETACHED ADDRESS LABELS

Valpak witness Haldi, VP-T-2, contends that the Postal Service's failure to assess separately the costs of Detached Address Labels (DALs) used solely for Standard Mail ECR Saturation Flats has resulted in an overcharge to Standard Mail letter-sized mail because of an understatement of the costs of Flats. MOAA's Standard Mail interest is catalogs, all of which are sent with address labels affixed. Therefore, MOAA will not specifically brief DALs, but leave it to those parties directly affected because they use DALs. Unfortunately, however, the Valpak approach is a classic case of throwing out the baby with the bathwater. Although he acknowledges that catalogs are not responsible for any understatement of costs resulting from DALs, witness Haldi nevertheless proposes to increase the rates for all flat-sized pieces. In sum, the Haldi solution bears no relationship to the alleged problem he has identified.

F) USPS ECR PROCEDURES

Witness Haldi's testimony attempts to demonstrate that letter sized mail is discriminated against. USPS witness Lewis, USPS-RT-2, summarizes the various operational procedures employed by the Postal Service for letter-shaped and flat-sized mail. The testimony establishes that the procedures for handling bundles, and other operational decisions, are based upon how mail can be best handled to meet service standards at the lowest possible cost. As stated by USPS witness Bradley, the Lewis testimony establishes that "the Postal Service faces only a few delivery days in which it must choose between casing letters and flats." USPS-RT-3 at iii. As he concludes, "the cost implications of this operational reality are included in the Postal Service/Postal Rate Commission costing methodology." *Id.* at iv.

G) MARGINAL COSTS

Witness Haldi also contends that the Postal Service's costing systems have failed to measure the marginal costs of ECR letters and non-letters. Tr. 9/5519-20. This is premised upon his argument that the Postal Service's ability to use a third bundle for the delivery of saturation mail is subject to capacity restraints and the further argument that the Postal Service has failed to recognize that, at the margin, this entails considerably higher costs. Tr./5521.

USPS witness Bradley has provided a comprehensive explanation of why witness Haldi's criticisms are not valid. USPS-RT-3 at 4-27. As concluded by him, the Postal Service "methodology produces the ratio of a product's total volume variable casing cost to its volume," which represents marginal costs. *Id.* at 17 (emphasis in original). The Postal Service methodology "does indeed measure marginal cost and does so over a variety of operating conditions." *Id.* at 27. The testimony of USPS witnesses Lewis and Bradley, taken together, demonstrates that witness Haldi has misconstrued the operational realities of the Postal Service and the cost implications thereof. The Postal Service's costing system "captures the cost implications of the operating behavior over a range of offices and volume profiles and does not fall into the trap of attempting to measure marginal costs based upon what could happen on only one day." USPS-RT-3 at iv.

H) DOUBLE COUNTING

Finally, Valpak's witnesses fail to address a significant issue of double counting that would result from the proposed increase in the rate differential between Letters and Flats unless there were to be a simultaneous reduction in the pound rate. The costs incident to handling Flats is recovered by the pound rate. MOAA has in the past maintained that the pound rate is excessive. That position has not changed, but we do not press it in this proceeding. Nevertheless, it remains obvious that there is no cost justification for nearly doubling rates with a doubling of weight which is the result produced by the rate schedule. This overcharge more than compensates for any arguable increased costs resulting from shape. As stated by Advo witness Crowder, "the passthrough of the letter-flat cost differential must be substantially less than 100 percent to avoid double-charging for weight related costs." Tr. 10/5737.

IV. SUMMARY AND CONCLUSION

The Postal Service has made a policy judgment about how best to meet the requirement to pay \$3.1 billion into escrow, a monetary obligation which is not the result of actual increased operating costs, but rather because of a statutory requirement unrelated to operating costs. MOAA supports the policy judgment, despite its regret that the escrow payment must be made. The testimony by Valpak witnesses has done nothing to show that this judgment was inappropriate. The Commission should accept the Agreement that has been signed by representatives of all but a small portion of the mail. The Service's testimony

including its rebuttal testimony provides ample and substantial evidence in support of its proposal.

PROPOSED FINDINGS AND CONCLUSIONS

For the reasons discussed above, the Commission should accept the Stipulation and Agreement that has been submitted by the Postal Service and parties to this proceeding.

Respectfully submitted,

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