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

Postal Rate And Fee Changes

Docket No. R2005-1

INITIAL BRIEF OF
PERIODICALS COALITION
SUBMITTED ON BEHALF OF
AMERICAN BUSINESS MEDIA,
DOW JONES & COMPANY, INC.,
MAGAZINE PUBLISHERS OF AMERICA, INC.,
THE MCGRAW-HILL COMPANIES, INC.,
AND
TIME WARNER INC.

September 26, 2005

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INITIAL BRIEF OF PERIODICALS COALITION

I. INTRODUCTION

The American Business Media, Dow Jones & Company, Inc., Magazine Publishers of America, Inc., The McGraw-Hill Companies, Inc., and, Time Warner Inc. (collectively “Periodicals Coalition”) are signatories to the Joint Stipulation and Agreement (“Settlement Agreement” or “Agreement”) submitted by the Postal Service. As such, we fully support the rates and fees and embodied in that Agreement (“settlement rates”). The settlement rates are supported by substantial record evidence and are consistent with the requirements of the Postal Reorganization Act. Public Law 91-375, 84 Stat. 719, 39 U.S.C. §§101 et seq. (“the Act”). We strongly support recommendation by the Postal Rate Commission (“Commission”), without change, of the settlement rates.

Were this a fully litigated proceeding, we may well have argued in favor of rates, classifications, ratemaking methodologies and estimated costs different from those embodied in the Settlement Agreement. As signatories, we defer such arguments to future proceedings and accept the evidence of record in this docket. Below, we explain why the policy judgment of the Board of Governors to request an across-the-board rate increase in this docket is appropriate and why the Commission should recommend the rates and embodied in the Settlement Agreement.

II. SUMMARY OF ARGUMENT

The Postal Service Request ¹ represents a policy judgment by its Board of Governors (Board) about the most reasonable, practical, and effective way to meet a currently unavoidable financial obligation in Fiscal year 2006. That obligation is a September 30, 2006, “escrow” payment of a \$3.1 billion required by the Postal Civil

¹ Request of the United States Postal Service for a Recommended Decision on Changes in Rates of Postage and Fees for Postal Services (April 8, 2005).

Service Retirement System Funding Reform Act of 2003.² The Postal Service Request is for a 5.4% “across-the-board” increase, effective no sooner than January 1, 2006. As of September 23, 2006, 36 parties have signed a Settlement Agreement in this docket.³ These 36 parties collectively represent every major class, subclass, and service affected by the Request. Even a competitor of the Postal Service, United Parcel Service, has signed the Agreement.

In Part III of this Brief, the Periodicals Coalition argues that the requested across-the-board increase is appropriate given (1) the singular character of the escrow expense and (2) the modest size and likely short duration of the requested increase. The near unanimous settlement confirms the reasonableness of the Board’s policy judgment and justifies the across-the-board approach. While the Commission must satisfy itself that the settlement rates comport with the law, given the broad support for this Request, it should not lightly displace or overrule the near consensus represented by the Settlement Agreement.

Part IV explains why the settlement rates meet the requirements of the law, fall within the Commission’s broad discretion to recommend rates, and are supported by the evidentiary record. The requested rates for each subclass cover attributable costs as required by 39 U.S.C. §3622(b)(3). Because the escrow costs are not caused by any subclass of mail or special service and do not vary with volume, it is appropriate to treat these costs as institutional. In recommending rates and assigning of institutional costs, the Commission has broad discretion to recommend rates that promote the fundamental well being of the Postal Service and its customers. In assigning institutional costs, the Commission is guided by the eight non-cost factors of the Act. 39 U.S.C. §3622(b)(1), (2), and (4)-(9). In this docket the Commission should be confident that the settlement rates comport with these factors.

Part IV. E. explains why the Commission should use the Postal Service cost estimates to evaluate the settlement rates. We point out that the Postal Service cost estimates are reasonable and will have no precedential effect. Thus, the Commission will be free to employ different methodologies, should it so prefer, in future dockets as it

² Public Law 108-18 (approved April 23, 2003), 117 Stat. 624.

³ Notice of United States Postal Service Filing Signatures for Stipulation and Agreement (September 23, 2005).

has done in the past. This is particularly the case with respect to the Postal Service's method for estimating mail processing volume-variability. Although that method differs from that employed by the Commission in prior dockets, it is reasonable and supported by substantial record evidence. We discuss refinements in that methodology the Postal Service implemented in this docket, particularly with respect to the selection of variables and errors in observation. These refinements address criticisms of the methodology expressed in prior dockets. Employing the Postal Service's methodology will ensure that, to the maximum extent practicable, the requested across-the-board increase is, in fact, *across the board*.

Finally, in parts IV. E. 3-4 we discuss the progress in Periodicals cost reduction initiatives underway with the Postal Service, and explain how the savings from those initiatives may exceed those estimated by the Postal Service.

For the reasons given in this brief, the Periodicals Coalition strongly urges the Commission to recommend the settlement rates requested by the Postal Service. Those rates are reasonable and appropriate, supported by substantial record evidence, and consistent with applicable provisions of law.

III. THE "ACROSS-THE-BOARD" RATE INCREASE REQUESTED IN THIS CASE IS APPROPRIATE AND FACILITATES SETTLEMENT

A. The purpose of the Postal Service's rate request distinguishes this case from conventional omnibus rate cases.

The Postal Service states that it considers itself obliged to propose a rate increase at this time only because it must make an escrow payment at the end of FY 2006. As stated by Postmaster General Potter (USPS-T-1 at 2):

The Postal Service's decision to seek changes in postal rates and fees at this time represents a policy judgment about the most reasonable, practical and effective way to meet a currently unavoidable financial obligation in Fiscal Year 2006. Otherwise, the Postal Service would not have filed this request now. Instead, in all likelihood, we would now be preparing to file in the future a more traditional omnibus filing.

In a "Request for Expedition" filed simultaneously with its rate Request, the Postal Service stated:

The Postal Service's Request presents a relatively modest revenue goal tied fundamentally to a single, unambiguous financial need in the test year (FY 2006), namely, the escrow requirement established by Congress in Public Law 108-18.⁴

If the escrow payment were an "operating expense" in the conventional sense of that term, i.e., an expense that is a normal incident of operating the Postal Service, that is expected to recur annually and can be projected with some confidence for a period of future years, or if it were in the nature of a capital expenditure, i.e., a non-recurring expense that can reasonably be amortized over a definite period of years that is roughly equivalent to the useful life of the thing for which the expense was incurred, then it would make little sense to single it out as the "cause" of any particular rate request. As correctly observed by the Postal Service, however, and as discussed more fully below, the escrow payment is singular in a number of respects that make it appropriate to deal with it separately from the rest of the Postal Service revenue requirement in this instance.

B. The singular character of the escrow expense and of the circumstances surrounding its creation makes it reasonable to apply an equal percentage increase approach in this proceeding.

There is no reason to suppose that an equal percentage across-the-board rate increase could not, in appropriate circumstances, serve "the public interest," effectuate "the policies" of the Act, and help to make possible "the development of postal services of the kind and quality adapted to the needs of the United States."⁵ The singular character of the escrow expense and the events surrounding its creation are such circumstances.

Most obviously, the escrow represents a sum paid by the Postal Service into an account presumably to be held in trust for the Postal Service's own benefit but not dedicated, as of this time, to any particular category of postal expense. The escrow

⁴ United States Postal Service Request for Expedition, filed April 8, 2005, at 6.

⁵ 39 U.S.C §§ 3622(a), 3622(b), 3621.

may be a temporary measure; that is, the funds may at some point be disbursed for the payment of Postal Service expenses. Passage in the House of Representatives and the pendency in the Senate of legislation that establishes conditions for the disbursement of these funds to the Postal Service, suggest that the obligation of the Postal Service to pay monies into the escrow account may not continue on a long-term or indefinite basis. The future of funds placed in escrow, however, remains uncertain, at least during the pendency of this docket.⁶ All of these factors make it inappropriate to force the escrow payment into the framework of a conventional omnibus rate case, where the specific purpose of expenses is reasonably well identified, where they are assumed to be recurring in the out-years, and where the issue of how they are to be distributed among the classes of mail has historically been addressed in the context of an expected three- or four-year rate cycle.

- C. Given the modest size and likely short duration of the proposed rate changes, the Postal Service's across-the-board proposal appropriately promotes a binding compromise by the parties regarding issues they would otherwise litigate thus facilitating settlement and expedition. This approach allows the Postal Service to propose the minimum increase necessary (no contingency, 2006 Test Year) and reduces the burdens and risks of litigation to all participants.**

The proposed across-the-board increase is anything but a conventional Postal Service "omnibus" rate proposal. Unlike conventional omnibus rate proposals, the proposed increase in this docket is intended to tide the Postal Service over for a short period, not to establish rates that will remain in effect for a three- or four-year cycle, as has been the case in the past. Unlike conventional omnibus rate proposals, the proposed increase in this docket is presented by the Postal Service as one of two possible alternatives, the other being almost immediate filing of a conventional omnibus rate case, based on a later test year and proposing substantially higher rate increases in the short-to-medium terms than mailers would otherwise have to bear. The across-the-board approach allows the Postal Service to propose the minimum increase

⁶ As the Commission recently noted in this docket, the "legislation that is working its way though [sic] the legislative process . . . may or may not ultimately become law." P.O. Ruling R2004-1/84 at 1. "Along the way it may be amended, which will result in different circumstances than those posited. . ." Id. at 4.

necessary (including a zero contingency for the 2006 Test Year) and reduces the burdens and risks of litigation to all participants.

D. The near unanimous settlement confirms the reasonableness of the Postal Service's approach and justifies the across-the-board approach.

The singular character of the circumstances surrounding this proposal, and in particular the wide acceptance of the Postal Service's representations respecting the far more onerous impact on mailers under the only alternative scenario, is evidenced by the near-unanimous agreement of the participants to a settlement that incorporates the Postal Service's proposed rates. No stronger evidence of the overall reasonableness of the Postal Service's across-the-board approach could be imagined than the near-unanimous agreement of the participants to forgo the litigation of issues in which they have historically strong interests and passionate disagreements, in return for the prospect of an expedited and simplified proceeding that will produce a rate increase of modest size and likely short duration.

The settlement agreement reached in this docket, embodying a binding compromise by nearly all participants with respect to issues that they would otherwise litigate--as distinct from agreements that merely indicate the *absence of litigable issues or disagreement among the participants*--is of precisely the type that the Commission has regarded as most helpful. For example, the Commission recently stated:

The Commission has a longstanding policy favoring the settlement of important issues through negotiations among participants, independent of Commission action. The settlement process allows participants to formulate proposals that represent a consensus as to the optimum approach to resolve contested issues. The settlement proposals that are generated facilitate the Commission's independent decision making process by informing the Commission of approaches to resolving contested issues that have been thoroughly considered and have the support of the participants agreeing to the settlement.

The settlement of contested issues facilitates the Commission's review of Postal Service requests because of its inherent efficiency and cost effectiveness.⁷

- E. The Commission should not lightly displace or overrule the near consensus represented by the Settlement Agreement so long as the proposed rates meet the requirements of law and fall within the Commission's broad discretion to recommend rates that promote the fundamental well being of the Postal Service and its customers.**

As a general principle, settlements of issues that would otherwise be litigated are in the public interest and should be encouraged. See Order No. 1443 at 14.⁸ The settlement of Docket No. R2001-1, combined with the nearly unanimous agreement to settle this case, have conserved the Commission's resources and saved participants millions of dollars. Although it appears at this point that the participants have chosen to litigate at least one contested issue—the rate relationship between ECR flats and letters—nearly all of the parties have agreed to resolve nearly all of the issues by settlement.

The Periodicals Coalition recognizes that it is the Commission's responsibility to ensure that postal rates are consistent with the standards set forth in the Postal Reorganization Act. Yet the exercise of that responsibility and the full and fair application of the statutory standards to appropriate data do not inexorably lead to only a single set of rates. Rather, especially given the degree that judgmental factors play a prominent role in the rate-setting provisions of the Act, there is a range of rates that would conform to its requirements and standards. Accordingly, the Commission is empowered to recommend rates that are not in its view perfect but that are in its view consistent with the statute and the public interest. Its flexibility is at its zenith, we submit, when assessing proposed rates to which nearly all parties agree.

⁷ Order No. 1443, issued August 23, 2005, at 14. See also *id.* at 16:

The Commission has commented on one instance where it is not helpful to file a Stipulation and Agreement at the conclusion of the settlement negotiation process. This is where the Stipulation and Agreement does not resolve any issues, but merely is used as a procedural mechanism to signal the Commission that no issues exist so that the Commission can proceed to making its recommendation. . . . In such circumstances, a simple notice that the participants have no disputes may be preferable.

⁸ The D.C. Circuit has consistently required agencies to give weight to settlements of the parties before it. See, e.g., *Union Elec. Co. v. FERC*, 890 F.2d 1193, 1194-95 (D.C. Cir. 1989).

The notion that there is no one set of lawful rates is well ingrained in regulatory jurisprudence, including that directly involving postal rates. In *National Association of Greeting Card Publishers v. USPS*, 462 U.S. 810, 820 (1983)(NAGCP IV), the Supreme Court rejected the overly-restrictive views of the U.S. Court of Appeals for the District of Columbia in *National Association of Greeting Card Publishers. v. U.S. Postal Service*, 569 F. 2d 570 (D.C. Cir. 1976), vacated on other grounds 434 U.S. 884 (1977), claiming that the D.C. court “misunderstood Congress’ solution” to the problems that had rendered the system of Congressional rate setting no longer tolerable. NAGCP IV at 822. “Congress did not intend to eliminate the ratesetter’s discretion,” the Supreme Court held, “it simply removed the ratesetting function from the political arena. . . .” Ibid.

Moreover, the Court agreed that even the measurement of attributable costs, expected to be more objective than the assignment of institutional costs, “is not a matter for the slide rule. It involves judgment on a myriad of facts. It has no claim to an exact science.” NAGCP IV at 825 , quoting *Colorado Interstate Gas Co. v. FPC*, 324 U.S. 581, 589 (1945). The Commission’s flexibility was given perhaps its greatest test with respect to its treatment of admittedly volume variable “Alaska air” costs as institutional. Affirming the Commission’s recommended decision, the court reaffirmed that “the Act itself does not require any specific cost method,” such that the term “attributable” can have “various meanings that support various attribution methods.” *United Parcel Service, Inc. v. U.S. Postal Service*, 184 F. 3d 827, 843 (D.C. Cir. 1999). A fortiori, various supportable attribution methods can support various rate arrays that, although different, can nevertheless be lawful. As the Supreme Court has recently reaffirmed, “regulatory bodies required to set rates in these [“just and reasonable”] terms have ample discretion to choose methodology. *Verizon Communications Inc. v. FCC*, 535 U.S. 467, 500 (2002).⁹

Whatever tolerance the Commission may have in contested cases for filed rates or intervenor-proposed rates that depart from its views of the most appropriate rates, in a settlement context the public interest is best served by the largest dose of tolerance that the Commission finds acceptable. Rejection of settled rates should result only from

⁹ See also *Midwest ISO Transmission Owners v. FERC*, 373 F. 3d 1361, 1371 (D.C. Cir. 2004), in which the court broadly held that “the cost causation principle does not require exacting precision in a ratemaking agency’s allocation decisions.”

a finding that they are plainly contrary to the Act and the public interest, not from a belief that alternative rates would have been better.

IV. THE SETTLEMENT RATES MEET THE REQUIREMENTS OF THE LAW, FALL WITHIN THE COMMISSION'S BROAD DISCRETION TO RECOMMEND RATES, AND ARE SUPPORTED BY THE EVIDENTIARY RECORD

A. As required by 39 U.S.C. §3622(b)(3), the rates for each subclass cover attributable costs, as supported by substantial record evidence.

As witness Kiefer points out,¹⁰ of the nine ratemaking criteria established by the Postal Reorganization Act, only criterion 3, 36 U.S.C. §3622(b)(3), which specifies that each class of mail must at least bear the direct and indirect postal costs attributable to that class, is an absolute requirement. See *also* PRC Op. R2000-1, para. 4003 citing (NAGCP IV); PRC Op. R2001-1, para. 2055. The Commission has interpreted this criterion as "requir[ing] an attributable cost floor, which the Commission historically satisfies by recommending rates that recover attributable costs." PRC Op. R2001-1, para. 2055.¹¹

Postal Service witness Robinson (USPS-T-27) shows that the settlement rates meet this requirement. Specifically, Test Year revenues for each subclass of mail and special service cover Test Year attributable costs, as calculated using the Postal Service's preferred costing methods. Exhibit USPS-27B (Revised 6/10/2005).

For multiple reasons discussed in Section IV. E. below, it is appropriate for the Postal Rate Commission to determine whether the settlement rates meet criterion 3 using Postal Service cost estimates: (1) the estimates are clearly within the bounds of reasonableness and are supported by substantial record evidence; (2) almost all of the

¹⁰ "Among the ratemaking factors enumerated in the Act, only the third (39 U.S.C. § 3622(b)(3) (attribution and assignment of costs)) is a 'requirement.'" USPS-RT-1 at 3 (Kiefer). "[T]his record evidence supports the Postal Service's position that the only *requirement* in Section 3622 of the Act has been met: that proposed rates must cover attributable costs and contribute to all other costs (Section 3622(b)(3))." *Id.* At 20.

¹¹ To satisfy criterion 3, the Postal Rate Commission also states that "the recommended rates must also be adequate to recover the Postal Service's remaining costs, *i.e.*, institutional costs." PRC Op. R2001-1, para. 2056. Postal Service witness Robinson finds that the settlement rates produce sufficient Test Year revenue (\$72.9 billion) to recover all of the Postal Service's Test Year costs (\$72.6 billion) Exhibit USPS-27B (Revised 6/10/2005).

parties, through the settlement agreement, agree to forego disputes concerning estimated costs in this docket; and (3) the Commission can employ these cost estimates without giving the procedures by which they were developed precedential standing as the Commission's preferred procedures.

B. Because the escrow costs are not caused by any subclass of mail or special service and do not vary with volume, it is appropriate to treat these costs as institutional.

While there has been much attention paid to the "escrow" issue in this docket, no witness has asserted that the escrow costs should be attributed. No one has challenged the classification of escrow costs as institutional. While Valpak witness Mitchell (VP-T-1) quibbles about how institutional costs should be calculated, even he concedes that the escrow costs should not be attributed. In his lengthy response to interrogatory DMA/VP-T1-2, parts b) and c), he states that "I agree that the escrow costs are not volume variable and should not be attributed..." and "[a]s I indicated in my response to part b) of this question, I agree that the escrow costs are an operating expense (so classified by Congress), do not vary with volume, and should not be attributed." Tr. 9/5395 and 5397 (Mitchell).

There is no evidence in this record that establishes a causal nexus between the escrow costs and any subclass of mail or special service. As Postal Service witness Tayman (USPS-T-6) accurately states:

To date, Congress has provided no legislative direction concerning the use of escrowed funds. The escrow is a legislated expense, over which management has no control, and provides no economic benefit to the Postal Service. The amount of the escrow expense is arbitrarily determined in the sense that it represents the difference between the funding requirement relating to a legitimate estimate of Postal Service's CSRS obligations and an estimate of these obligations that was determined to be substantially in error.

USPS-T-6 at 12 (Tayman).

The Commission has consistently required a causal relationship before costs are attributed, explaining "attributable cost means costs which can be said to be reliably caused by a subclass of mail or special service." PRC Op. R97-1, para. 4017. Its

position was upheld by the Supreme Court in NAGCP IV, where the Court embraced the Commission's view that the Postal Reorganization Act "requires the establishment of a sufficient causal nexus before costs may be attributed." NAGCP IV at 826. Clearly, an arbitrarily-determined expense that the Postal Service is not allowed to use to its economic benefit and for which no direction has been provided is not reliably caused by any subclass of mail or special service. Therefore, the Postal Service classification of the escrow costs as institutional is appropriate. Exhibit USPS-10H at C-24.

C. The Commission has broad discretion to recommend rates that promote the fundamental well being of the Postal Service and its customers.

There can be no doubt that the escrow payment constitutes a part of the "total estimated costs of the Postal Service" that are required, under §3621 of the Act, to be recovered through "[p]ostal rates and fees":

Postal rates and fees shall provide sufficient revenues so that the total estimated income and appropriations to the Postal Service will equal as nearly as practicable total estimated costs of the Postal Service. For purposes of this section, "total estimated costs" shall include (without limitation) operating expenses . . . [and] debt service (including interest, amortization of debt discount and expense, and provision for sinking funds or other retirements of obligations to the extent that such provision exceeds applicable depreciation charges), and a reasonable provision for contingencies.

39 U.S.C. §3621.

The Act creating the escrow obligation specifies that the funds required to be placed in escrow shall be treated as "operating expenses." Public Law 108-18 , § 3(a)(3). If they were not so treated, they would still evidently fall within §3621's definition of "estimated costs of the Postal Service" because of the parenthetical phrase "(without limitation)." Any sum for which the Postal Service is legally obligated and for which no "appropriations" have been provided must logically constitute a part of the "total estimated costs of the Postal Service" if the Act's central purpose of creating a self-sustaining postal service is to be achieved. See 39 U.S.C. §3621.

To say that the escrow funds constitute a part of the "total estimated costs of the Postal Service," however, does not in itself answer the question of *how* those costs are to be incorporated in "[p]ostal rates and fees." The answer to that question is provided in main part by the remainder of §3621 and by §3622, which sets out the ratemaking factors that govern the Commission's consideration of a Postal Service rate request. Section 3622, of course, includes both subsection (b)(3)'s "requirement" that "each class of mail or type of mail service" shall bear its own attributable costs and the enumeration in subsections (b)(1)-(2) and (4)-(9) of the non-cost factors that must guide the Commission in "reasonably" assigning non-attributable costs among the various classes. As discussed above in section III. A., the Postal Service's proposed rates and fees in this docket satisfy the attribution requirement of (b)(3). The central question before the Commission is whether they also satisfy (b)(3)'s reasonable assignment provision.

That question can best be addressed by considering, first, the breadth of the § 3622(b) assignment factors and, second, the unusual specific circumstances of this docket, including the singular character of the escrow expense and of the circumstances surrounding its creation and the existence of a near-unanimous settlement agreement in support of the Postal Service's proposal.

Appreciation of the breadth of the §3622(b) assignment factors may begin with the observation that §3621 includes more than the provision that postal rates and fees (plus appropriations) should "equal as nearly as practicable total estimated costs of the Postal Service." It also contains the following:

Postal rates and fees shall be reasonable and equitable and sufficient to enable the Postal Service under honest, efficient, and economical management *to maintain and continue the development of postal services of the kind and quality adapted to the needs of the United States* [emphasis added].

One must also consider the language of §3622(a), which provides that

the Postal Service shall request the Postal Rate Commission to submit a recommended decision on changes in a rate or rates of postage or in a fee or fees for postal services *if the Postal Service determines that such*

changes would be in the public interest and in accordance with the policies of this title [emphasis added].

And one must consider the terms in which the nine §3622(b) factors are introduced:

Upon receiving a request, the Commission shall make a recommended decision on the request for changes in rates or fees in each class of mail or type of service *in accordance with the policies of this title and the following factors [emphasis added]* . . .

It is evident that these expansive references in §§3621 and 3622 --to "the development of postal services of the kind and quality adapted to the needs of the United States," "the public interest," and "the policies of this title"--can be given meaning, if at all, only in the application of the §3622(b) assignment factors. The broad scope of the Commission's responsibility and discretion in applying these factors is further confirmed by the fact that they are explicitly denominated "factors," a term that has a specific and well-settled meaning in administrative law as *something that must be weighed or taken into consideration by the regulator but that does not have a predetermined significance or weight with respect to the outcome*. Thus, in the *Permian Basin Area Rate Cases*, 390 U.S. 747, 791-92 (1968), the Supreme Court stated that although a reviewing court will examine a regulatory agency's methods and its balancing of interests, its role "is not to supplant the [agency's] balance of these interests with one more nearly to its liking, but instead to assure itself that the [agency] has given reasoned consideration to each of the pertinent factors." See also, *Citizens to Preserve Overton Park v. Volpe*, 401 U.S. 402, 416 (1971):

Section 706 (2) (A) [of the APA] requires a finding that the actual choice made was not "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law." To make this finding the court must consider whether the decision was based on a consideration of the relevant factors and whether there has been a clear error of judgment. [internal citation omitted].

It is further confirmed by the existence of factor (9), "such other factors as the Commission deems appropriate," and by legal precedents indicating that the courts will not substitute their own judgment for that of the Commission in applying these factors. See section III. E., supra.

D. All but one of the §3622(b) factors address the distribution of burdens among various types of mailers. The Commission should be confident that the settlement rates comport with these factors.

As discussed in section IV. A., supra, only one of the ratemaking factors set forth in § 3622(b), § 3622(b)(3), is an absolute requirement. The other eight factors address the distribution of institutional costs among various types of mailers. Postal rate litigation traditionally centers on this distribution of burdens. It is this type of usually contentious litigation that the signatories to the Settlement Agreement have agreed to forego. The fact that nearly all of the parties, through the settlement process, signal their willingness to forego pursuit of their interests through litigation attests to the reasonableness of the distribution of burdens among the various types of mailers at least given the unique circumstances surrounding this docket. This substantially reduces, if not entirely nullifies, the weight that the provisions of §3622(b) normally carry. The willingness of almost all interested parties to agree to a settlement demonstrates that there is broad support for the distribution of the burdens and benefits among participants.

E. The Commission should use the Postal Service cost estimates to evaluate the settlement rates.

1. The Postal Service cost estimates in this docket are reasonable and recommending rates and fees based on those estimates will have no precedential effect.

The cost estimates of the Postal Service that support its requested rates and fees are clearly within the bounds of reasonableness. The fact that nearly all interested parties, through the settlement process, chose not to dispute these estimates attests to their reasonableness. While certain methodologies employed by the Postal Service differ from those preferred and recommended by the Commission in previous dockets, the Commission need not worry that recommending the rates and fees supported by the Postal Service methodologies will impair the ability of the Commission to exercise its discretion in future dockets. Parties to the Settlement Agreement agree that this docket will have no precedential effect. Paragraph 12 of that Agreement provides:

The signatories agree that, in any future proceeding, adherence to this agreement is not intended to constitute or represent agreement with, or concession to the applicability of any ratemaking principle, any method of cost of

service determination, any method of cost savings measurement, any principle or method of rate or fee design, any principle or method of mail classification, any terms and conditions of service, or the application of any rule or interpretation of law, that may underlie, or be thought to underlie, this Stipulation and Agreement.

Notice of the United States Postal Service Submitting Stipulation and Agreement (July 22, 2005).

Further, commenting on similar language in the settlement agreement in Docket No. R2001-1, the Commission made clear that such language ensures that a settlement agreement has no precedential effect.

Ordinarily, there is controversy in each rate proceeding concerning the measurement of attributable costs for purposes of establishing criterion 3's attributable cost floor. The settlement, however, moots the need to resolve such issues because, by its terms, it does not bind the signatories to any costing or ratemaking principle. See, Stipulation at § II 9. Nor does the Commission's approval of the settlement bind it. Nothing in the Request, the Commission's Recommended Decision, or the Governors' Decision shall have precedential effect in future cases.

PRC Op. R2001-1, para. 2057.

2. The Postal Service's method for estimating mail processing volume-variability is reasonable and supported by substantial record evidence.

The Postal Service's method for estimating the variability of mail processing costs is both reasonable and supported by substantial record evidence. In its Opinion and Recommended Decision in Docket No. R2000-1, the Commission stated that using econometric methods, as the Postal Service has again done, is a reasonable approach to calculating mail processing volume variabilities: "The Commission believes that econometric methods properly applied to correctly formulated economic models with a reasonably complete and error-free data set is the only way to obtain accurate and unbiased estimates of structural parameters such as volume variabilities." PRC Op. R2000-1, Appendix F at 52.¹²

¹² Docket No. R2000-1 was the last case in which the Commission fully examined the Postal Service's method for estimating mail processing volume variabilities.

In this case, witness Bozzo (USPS-T-12) squarely addresses the major methodological concerns raised by the Commission in R2000-1. Specifically, Bozzo makes substantial progress with both the formulation of the Postal Service's economic models and with issues related to data errors.

(a) Selection of variables.

In Docket No. R2000-1, the Commission criticized Bozzo's use of a plant-wide index of capital and his use of the "manual ratio" representing the ratio of manual piece handlings to total piece handlings. PRC Op. R2000-1, Appendix F at 46. In this docket, Bozzo responds to this criticism and develops separate capital indices for letter sorting operations and for flat and bundle sorting operations in place of the single plant-wide capital index he used previously. USPS-T-12 at 39 (Bozzo). In addition, implicitly following the Commission's previous criticisms and the reasoning provided by the OCA-sponsored research of Professor Roberts in 2002,¹³ Bozzo drops the use of the manual ratio. USPS-T-12 at 42 (Bozzo).

In Docket No. R2000-1, the Commission also criticized witness Bozzo's treatment of the capital index as endogenous and his use of plant fixed effects. PRC Op. R2000-1, Appendix F at 46-47. In this docket, Bozzo discusses the additional corroboration for these two variable selection decisions provided by the OCA-sponsored research of Professor Roberts in 2002. OCA 2002 at 11, 31-34, and 39-45; USPS-T-12 at 10-12 and 23-26 (Bozzo).

(b) Errors in observations.

In Docket No. R2000-1, the Commission raised serious concerns about errors in the MODS data used for witness Bozzo's econometric estimates of volume variability and their potential to introduce "errors-in-variables" biases in those estimates. PRC Op. R2000-1, Appendix F at 38-44. In this docket Bozzo adopts the instrumental variables technique introduced by the OCA-sponsored research of Professor Roberts in 2002.

¹³ OCA, May 2002, "An Empirical Model of Labor Demand for Mail Sorting Operations" (OCA 2002) at 28. The paper, supporting materials, and audio of the seminar are available on the internet at <http://www.prc.gov/OCA/OCApapers.htm> (March 1, 2005).

OCA 2002 at 49-55; USPS-T-12 at 26-27 (Bozzo). This technique corrects for biases in the volume variability estimates that could be introduced by measurement error thereby addressing the Commission's Docket No. R2000-1 concerns about the impact of MODS data errors on the econometric estimates of mail processing volume variability.

Bozzo applies the instrumental variables technique only to the manual cost pools, because of analyses by UPS witness Neels in Docket No. R2000-1 (UPS-T-1 at 24-25) showing "high reliability of machine-counted TPH data," thus making corrections unnecessary for the automated cost pools. USPS-T-12 at 15 (Bozzo). An analysis of the impact of the instrumental variables technique shows that it increases the volume variability estimates in the manual cost pools, reversing an apparent downward bias from measurement error compared to the volume variability estimates when the technique is not used and the impact of the data errors is uncorrected. However, Bozzo's estimation of volume variabilities for the automated cost pools using the instrumental variable specification shows no overall increase in their volume variabilities, consistent with Bozzo's argument that measurement error is not likely to be an important problem for these cost pools. USPS-T-12 at 57-58 (Bozzo). Thus, Bozzo both detects and corrects the error-in-variables bias that was a primary reason for the Commission's rejection of the Postal Service's econometric estimates of mail processing volume variability in Docket No. R2000-1.

These substantial improvements in witness Bozzo's econometric approach eliminate previously identified potential sources of inaccuracy and bias in the Postal Service estimates of mail processing volume variability.

3. Periodicals cost reduction initiatives, which will significantly reduce Test Year costs, are moving forward rapidly.

The Postal Service has made significant progress in implementing the Periodicals Cost Reduction Initiative.¹⁴ As of four months ago, when Postal Service

¹⁴ Through the Periodicals Cost Reduction Initiative, "[f]unctions throughout the organization will carry out a management objective over the next 12 to 18 months to aggressively reduce the processing and transportation costs associated with the handling of Periodicals Mail." Major focus areas of the initiative include automating and consolidating outgoing processing; increasing the use of automation for the

witness McCrery (USPS-T-29) responded to a Presiding Officer's Information Request (P.O. Information Request No. 3 (April 29, 2005)), the Postal Service had already started to work with its field operations staff and members of the Periodicals mailing industry to identify and develop opportunities to reduce Periodicals costs and had made significant progress towards implementation. Tr. 5/1686-9 (McCrery).

According to McCrery, as of mid-May, the Postal Service had already implemented or was planning to implement changes soon thereafter to improve the efficiency of outgoing processing, increase the use of automated equipment for piece distribution, reduce sack-handling costs, and reduce bundle-processing costs:

- To increase the efficiency of outgoing periodicals processing, the Postal Service is in the process of consolidating the outgoing bundle and piece distribution operations and requiring mailer compliance for labeling. Tr. 5/1686 (McCrery).
- To increase the use of automation for periodicals processing, the Postal Service plans to issue additional directives to focus additional attention on the ongoing effort. Tr. 5/1686-7 (McCrery).
- To reduce sack-handling costs, the Postal Service plans to issue a Postal Bulletin notice allowing mailers to enter mailings at destination on small pallets and a notice requiring that mailers use lower weight pallets in certain situations. Tr. 5/1687 (McCrery).
- To reduce bundle processing costs, the Postal Service plans a multi-pronged initiative to improve bundle integrity. The initiative includes using its Electronic Mail Improvement Reporting (eMIR) system to blitz the issue, changing bundle preparation standards, and an education campaign. Tr. 5/1688-9 (McCrery).

As the Postal Service works toward national implementation of these initiatives, it is already experiencing the benefits of the changes at the local level through the use of local exceptions. Tr. 5/1687 (McCrery).

Implementation of the Periodicals Cost Reduction Initiative should proceed smoothly and rapidly since, as discussed by McCrery, the Postal Service has been and will continue coordinating closely with the parties that will

incoming secondary processing of Periodicals; shifting the containerization of Periodicals away from sacks; and improving bundle integrity. USPS-LR-K-49 at 20.

ultimately be responsible for implementing these changes – the Periodicals mailing community and postal field operations.

The Postal Service has solicited feedback from both postal field operations and various industry stakeholders during the identification, development, and implementation of many of the referenced options. For example, all of the referenced options have been or will be topics of discussion at both the Periodicals Operations Advisory Committee and MTAC Flat Mail Preparation Optimization meetings. There have also been informal discussions with representative associations to identify additional opportunities for Periodicals. The expectation is that these discussions will be ongoing as our mutual interest to lower the cost of Periodicals remains at a high level.

Tr. 5/1686 (McCrery).

4. The Skin Sack Reduction Program is likely to produce savings far greater than those conservatively estimated by the Postal Service.

In its roll out, the Postal Service estimates that the Skin Sack Reduction Program – which will eliminate the current Periodicals option of preparing 5-digit, 3-digit, and ADC sacks containing fewer than 24 pieces – will eliminate approximately 38 million sacks and reduce Test Year costs for Periodicals by a cumulative \$22 million. USPS-LR-K-49 at 19; USPS-LR-K-49, Attachments C and D; Tr. 5/1690 (McCrery).

While the Postal Service's estimate of the number of eliminated sacks is reasonable, the cost savings are likely to be significantly greater than estimated. This is because the Postal Service's Docket No. R2005-1 cost model excludes significant cost savings that will occur from this program. The Postal Service operations witness confirmed this in response to a Presiding Officer's Information Request (P.O. Information Request No. 3 (April 29, 2005)):

It should be noted that the estimate is conservative since it reflects only savings at the destination facilities. However, it would be expected that further workhour reductions will be realized at origin facilities with fewer origin sack handlings and through a reduction in the overall network sack sorting workload for Periodicals.

Tr. 5/1692 (McCrery).

While witness McCrery did not quantify how conservative the savings estimate is, the Periodicals Cost Analysis Model, a Postal Service cost model that was filed by the Postal Service as USPS-LR-I-332 in Docket No. R2000-1, suggests that the cost savings is likely to be substantially higher than the Postal Service's estimate. That model, which estimated costs at both origin and destination facilities, calculated the average Test Year 2001 cost for handling a Periodicals sack to be nearly three dollars.¹⁵ At a cost of nearly three dollars per sack, eliminating 38 million sacks will reduce Test Year Periodicals costs by several times the \$22 million conservatively assumed by the Postal Service.

The Periodicals Coalition understands that using Test Year 2001 costs from the Docket No. R2000-1 Periodicals Cost Analysis Model to estimate Test Year 2006 cost savings from the Skin Sack Reduction Program will not yield *precise* cost savings estimates. However, it does serve to illustrate the magnitude of the program's cost savings, which are likely to substantially exceed the Postal Service's estimates.

V. CONCLUSION

For the reasons given in this brief, the Periodicals Coalition strongly urges the Commission to recommend the settlement rates requested by the Postal Service. Those rates are reasonable and appropriate, supported by substantial record evidence, and consistent with applicable provisions of law.

¹⁵ The Periodicals Cost Analysis Model's average cost per sack can be calculated by dividing the estimated cost of sacks (\$145,264) by the number of sacks (51,968) from Docket No. R2000-1, USPS-LR-I-332, Table 8.

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