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

Postal Rate and Fee Changes, 2005 )

Docket No. R2005-1

Reply Brief

of

The Office of the Consumer Advocate

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## I. Summary

This is a case of first impression. Never before has the Postal Service had positive cumulative net income. Not only were the earnings positive in FY2004, they will grow, according to the Postal Services filing, to \$2.5 billion by the end of FY2005. It is OCA's position that the cumulative earnings of the Postal Service must be taken into account and considered pursuant to §3621 of the PRA when calculating the revenue requirement. This reply brief responds to the one argument put forth in the initial briefs by only one party, Parcel Shippers Association (PSA). PSA contends OCA's view would be inconsistent with the test year approach of the Commission. We disagree and part A below responds to that argument.

This reply brief also responds to certain other statements in the initial briefs that may be misleading unless placed into the appropriate context. The so-called settlement has many signatories, but it is not nearly as representative of mailers having a significant financial impact on the Postal Service as they would have the Commission believe. Also, OCA's position is not intended to, nor does it, infringe upon management's discretion to manage its debt load. This reply brief also points out there is no record evidence that including the cumulative earnings in the test year revenue and thereby dramatically reducing to 0.8 percent the proposed 5.4 percent rate increase or, alternatively, to defer the increase for only about seven months, will have any impact whatsoever on the Postal Service's ability to maintain and develop postal services as is required by the PRA. Also, more recent Postal Service estimates of test year revenue and costs prepared for its FY2006 operating plans are unreliable and untested on this record. They are not a part of this record and should have no bearing on the

Commission's decision in this proceeding. Finally, there is a strong probability that passage of the proposed legislation will allow the Postal Service to reap huge profits through unnecessary rate increases that will never be returned to its customers.

Lastly, OCA commends the Postal Service for its commitment to post certain national service performance data on its website.

## II. Argument and Discussion

### A. Including the Retained Earnings In the Revenue Requirement Would Not Be Inconsistent With the Commission's Test Year Approach.

The OCA indicated early in this proceeding the position expressed in our initial brief that the PRA requires the Commission to take into account the cumulative net income of the Postal Service as of the end of FY 2005 in determining the revenue requirement for FY2006.<sup>1</sup> The OCA made this point on several occasions during discussions with the parties during the proceedings, in interrogatories, and during cross-examination.<sup>2</sup> Nevertheless, only one brief even touches upon this important point of law that might easily cause the Commission's action to be overturned in a Court of Appeals if it is not properly addressed. Simply stated, the PRA does not provide for the Postal Service to retain earnings. Similarly, the PRA provides no leeway to the Commission, and it must take retained earnings into account in a proceeding under §3621.

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<sup>1</sup> "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.

<sup>2</sup> "Office of Consumer Advocate Opposition to United States Postal Service Request for Expedition and Early Consideration of Procedures Facilitating Settlement Efforts," April 29, 2005; Tr. 2/111 (OCA/USPS-T6-4); Tr. 2/132 (OCA/USPS-T6-18); Tr. 73-76.

The brief of PSA notes only that the OCA's position "is not consistent with the Postal Rate Commission's practice of recommending rates that recover its total costs in a future Test Year and thus should be rejected." (PSA Br. at 7.) OCA recognizes that if, before rates, retained earnings are included in the revenue requirement calculation, the Postal Service operations would appear to generate a loss during the test year. Nevertheless, in OCA's view the retained earnings should be treated as revenue during the test year. The rates generated must be based upon total overall revenue (including retained earnings) equating to costs in the test year.<sup>3</sup> That is, if one looks only to the revenue generated from operations, interest income and appropriations in the test year, as compared to the costs from operations incurred in the test year, there would appear to be a loss. However, if retained earnings are considered in establishing rates, the rates would be based upon a balancing in the test year of overall revenues (including retained earnings) and costs. Thus, the OCA is not inconsistent with or deviating from the Commission's traditional test year approach to rate-making.

The adjustment to the revenue requirement proposed here by OCA is no different from the test year approach than the adjustment the Commission has made to costs when it included amounts to recover prior years' losses in the revenue requirement. Absent the adjustment for prior years' losses, the revenue from rates and fees in those cases would have appeared to create excessive revenue in the test year, but including the amount to recover prior years' losses balanced the equation for the test year. OCA's position works in the same manner.

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<sup>3</sup> The OCA pleadings on this point have stated merely that the Postal Service does not need to breakeven in the test year in the usual sense of the term. OCA Init. Br., at 4.

We should point out the PRA does not mention a test year. In fact, it is silent as to the period over which rates and fees shall be sufficient so that total estimated income and appropriations will equal as nearly as practicable total estimated costs of the Postal Service. There is no basis for not taking the entire amount of the retained earnings into account as revenue in the test year.

B. The Support For The Settlement Should Not Be Construed As An Indicator Of Full Customer Support For A Premature Revenue Increase.

The Postal Service has obtained signatures from 36 parties to this proceeding in support of its settlement proposal.<sup>4</sup> On brief, several of the parties to the settlement indicate the settlement has the support of all but an insignificant few of the Postal Service's customers. For instance, the Postal Service says that in developing the consensus represented by the settlement agreement it has "sought the widest possible involvement by mailers and organizations interested in its proposal."<sup>5</sup> Another brief states the settlement is supported by "all but a fraction of total mailers."<sup>6</sup> Yet another states that those not signing are "not entities that ultimately bear the financial burden" of the rate increase.<sup>7</sup> Others suggest the same point.

These parties to the settlement overstate their significance in the overall picture of the Postal Service's business. The Commission should not be unduly swayed by their statements. While they may comprise the majority of the intervenors, there are

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<sup>4</sup> USPS Init. Br., at II-14.

<sup>5</sup> Id. at II-12.

<sup>6</sup> MOAA Init. Br., at 4.

<sup>7</sup> Discover Init. Br., at 3.

other significant numbers of Postal Service customers who are not a party to the settlement. In fact, one large business customer, Valpak is strenuously opposed to the settlement. Valpak, like OCA, contends current law does not permit retained earnings.<sup>8</sup> Other individuals and participants are not parties to the settlement but have raised important legal issues.

Most significantly, millions of other persons who are not parties to this proceeding, such as household customers and small business users of First-Class Mail, parcel post and other packages services, and special services will be negatively impacted by the premature rate increases furthered by the Postal Service settlement. They are not signers of the settlement. OCA's charter calls for the Office to provide "representation for the interests of the general public"<sup>9</sup> For instance, the general public includes households and small businesses not otherwise represented in this proceeding. The Postal Service reported it served 130 million city and rural residential delivery points as of the end of FY2004.<sup>10</sup> It also provided service to more than 12 million business delivery points. All, or virtually all, of these 142 million delivery points have individuals sending single-piece non-presorted 37 cent mail at some time during the year. Unsorted single-piece mail accounted for \$20.5 billion of the Postal Service's revenue in FY2004.<sup>11</sup> In addition, those same individuals contribute substantial revenues from the use of Priority Mail, and Express Mail. They are also significant

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<sup>8</sup> Valpak Br., at I-13.

<sup>9</sup> 39 C.F.R. §3002.7.

<sup>10</sup> 2004 USPS Annual Report, at 54. The Commission can take official notice of Postal Service Annual Reports. Opinion and Recommended Decision, Docket No. R97-1, May 11, 1998, at 24, note 3.

<sup>11</sup> LR-K-3, "USPS Cost and Revenue Analysis, FY2004," Summary of Revenue and Cost for Major Service Categories.

users of Special Services which combined provide \$2.5 billion of revenue.<sup>12</sup> OCA's position is that their voice, although not a part of the settlement, is also important and reflects, by itself, a proportion of the Postal Service's business (over one-third) at least as financially significant as that represented by all those groups signing the settlement.

In fact, the settlement is hardly a settlement at all. Its terms do not provide for postage rates and fees or terms of service at variance from the rate request filed by the Postal Service. Many, if not all, of the signatures were not obtained until after opportunity for hearings, including rebuttal testimony. The settlement signatures represent nothing more than an agreement not to oppose, on brief or on appeal, the across-the-board rate increase proposed by the Postal Service.<sup>13</sup> The settlement discussions forestalled argument among most customers as to the appropriate cost attributions that have not been updated for several years through more than one rate proceeding. Also, the parties settling did not focus on the issues raised by the OCA as to the legality of the Postal Service retaining its cumulative earnings stockpile and the appropriateness of other matters raised in OCA's initial brief such as mail processing and carrier costing methodologies and the insufficiency of measurements and data necessary to determine the quality of postal service actually provided.

The silence of the parties to the settlement in this case should not necessarily be construed as disagreement with the argument that the rate increase ought to be reduced or that the rate increase should be delayed until the cumulative earnings are reduced to breakeven. The motives of the signatory parties, in agreeing to settle for an earlier implementation of rate increases than necessary, could vary widely. The sheer

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<sup>12</sup> Ibid.

cost of litigation may encourage settlement rather than full-blown rate proceedings in which one group of large customers argues against another group over the allocation of costs. Yet, it is difficult to understand why the settling parties are willing to accept a 5.4 percent increase months sooner than is otherwise necessary merely to mitigate the size of a subsequent rate increase. This is especially difficult to understand if they believe the Postal Service should not accrue retained earnings. If, as we contend, the rate increase leads to ever greater retained earnings, (and that does not even include the possibility the escrow fund may be eliminated shortly after the rates are implemented in which case retained earnings will balloon by the foregone \$3.1 billion escrow payment) then there is no indication from the Board of Governors that it would ever accede to returning the retained earnings to the ratepayers. It seems that, essentially, those parties settling this case have agreed to pay in advance monies they will never see again just to have a lower percentage rate increase in the next rate case.

The mission of the OCA is to take a position in the best interests of the millions of households and small business customers whose interests are, in many ways, different from those of the Postal Service's large business customers. Likewise, the Commission as an independent agency must reach its recommendation free of the competitive pressures of business and make recommendations that are overall consistent with the law and public interest and should not necessarily be influenced by the ostensible support for the settlement agreement.

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<sup>13</sup> USPS Init. Br., at II-15.

C. Management Discretion To Determine When To File A Rate Case And Whether To Incur Debt For The Escrow Payment Does Not Nullify Or Supersede Statutory Requirements.

The Postal Services' brief discusses its decision to request a rate increase and the principal alternative of offsetting the escrow payment by increasing debt. It says increasing rates is a course consistent with both the intent of P.L. 108-18 and its discretion to prudently manage the affairs of the Postal Service.<sup>14</sup> OCA is concerned these points may appear to dispose of the OCA proposal to take cumulative earnings into account inasmuch as, in doing so, it may result in the Postal Service incurring some debt that the Postal Service management, in exercising its discretion, would not otherwise incur if the Postal Service received the entire rate increase.

Although the Postal Service management has determined in its discretion that financing the escrow requirements through debt would not be desirable,<sup>15</sup> management is nevertheless bound by applicable laws. Some of the briefs specifically recognize this limitation, conditioning their support for the settlement upon the recognition that the Commission's approval of the settlement must be "consistent with the law."<sup>16</sup>

OCA's Initial Brief explained the manner in which Public Law 108-18 requires the Postal Service to utilize the savings generated by that law to defer rate increases. The Postal Service's cumulative earnings are undoubtedly the result of the savings

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<sup>14</sup> USPS Init. Br., at III-4-5.

<sup>15</sup> USPS Init. Br., at III-1-8.

<sup>16</sup> See Periodicals Coalition Init. Br., at 7; NAA Init. Br., at 1.

generated by that law.<sup>17</sup> Thus, in that law alone, Congress strongly urged, if not required, the Postal Service to postpone rate increases so that mailers may benefit from the savings created by P.L. 108-18.

Moreover, the OCA position does not trench upon the Postal Service's management prerogatives under the PRA to determine whether to delay a rate increase or to incur debt. The OCA does not take issue with the management's decision that financing the escrow payment though debt is undesirable or with the management's discretion to maintain and build up retained earnings between rate cases until it files for a rate increase. Those matters are beside the point. In the relevant portion of §3621, once management exercises its discretion to file rate case, its discretion is thereby limited. In determining the revenue requirement once a rate case has been filed, the Commission is bound to establish rates based upon the overall rates equation: estimated revenues must equate as nearly as practicable to estimated costs. This is the process the Commission has followed since the inception of the Commission. Having once received a request for a rate increase, the Commission's duty is to determine that balance and establish rates accordingly. If the Commission modifies the revenue requirement, the requested rates are modified accordingly. Subsequently, the Postal Service's financial position at the end of the test year will vary from that which it estimated in its rate request and debt may or may not be incurred to meet the changed rates. Of course, circumstances may also vary from the assumptions and debt requirements may be altered in that way as well. Thus, although the impact of the

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<sup>17</sup> OCA Br. at 22, "P.L. 108-18 explicitly states that the savings arising from payments that the Postal Service was spared in 2003, 2004, and 2005 are to be used to maintain the lowest possible rates for mailers."

Commission's decision may be to alter the amount of debt that the Postal Service management believes is required to meet its operations at the end of the test year, it is well settled in practice that Commission adjustments to a rate request do not infringe upon the discretion of the Postal Service's management prerogative to manage its debt.

It is important to bear in mind that the Postal Service and the Commission *explicitly* address the cumulative net loss that gives rise to prior year loss recovery in a series of rate cases. However, the Postal Service in its discretion has maintained complete silence on any future disposition of the net cumulative income that OCA challenges in this proceeding. Since the Postal Service appears to be attempting to arrogate power to retain earnings without limit and without intervention by the Commission,<sup>18</sup> it is essential to establish in this proceeding that this type of cash stockpiling is a violation of §3621. OCA does not completely rule out the possibility that, in a future proceeding, if the Postal Service shows a small cumulative net income in the test year and unambiguously lays out a plan to draw down the surplus to breakeven by a series of rate request offsets (i.e., the rates requested are reduced to reflect that a cumulative net income is still being carried), such a plan *might* be consistent with §3621; but this scenario is purely hypothetical. The Postal Service has not made any commitment to use the cumulative surplus to extend even a penny of rate relief to current mailers. Furthermore, these particular surpluses – that arise largely from

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<sup>18</sup> OCA asked witness Tayman: "Is there any maximum amount of cumulative net income appropriate for the Postal Service? If so, is \$5 billion an appropriate maximum cumulative net income? Is \$50 billion an appropriate maximum cumulative net income? If so, please explain and indicate what that amount may be?" He answered: "Management should be responsible for determining an appropriate amount of cumulative net income." (His response to interrogatory OCA/USPS-T6-41, Tr. 2/156.

foregone CSRS payments under PL 108-18 – should be applied to give immediate rate relief under the language and principles of PL 108-18.

An important additional consideration, raised in OCA's Initial Brief (at 13), is that prior year loss recovery necessarily must take place gradually, or rate shock will ensue. Offsetting the full amount of net cumulative income in a single proceeding involves no such risk.

D. There Is No Evidence That Deferring the Rate Increase Would Impact the Postal Service's Ability To Maintain And Develop Postal Services As Required By the PRA.

The Commission is bound by §3621 to assure the rates and fees are “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.” There is not one shred of evidence in this record indicating that recognizing retained earnings in the revenue requirement will have any impact upon the ability of the Postal Service to maintain and continue the development of postal services. To be sure, witness Tayman has discussed the potential impact on the future borrowing needs of the Postal Service and the desire to mitigate the amount of the subsequent rate increase if the Postal Service financed the entire escrow agreement with debt.<sup>19</sup> Leaving aside the fact that OCA is not suggesting funding the escrow payment with debt, even that situation would not have a deleterious effect upon the Postal Service's ability to maintain and develop its postal services. The Postal Service had the opportunity to place in the record any negative impact that

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<sup>19</sup> USPS-T-6, at 16-17.

financing a portion of the escrow payment might have on postal operations, but none was offered. The only evidence as to the potential impact of incurring additional debt to fund the escrow payment relates to financial operations and the amount of additional debt that would be necessary. That evidence indicates the additional debt would be minimal and would not exceed legal debt limitations.<sup>20</sup> There is no evidence of any potential restrictions on postal operations resulting from the OCA position.

- E. A Recent Postal Service Press Release Regarding its Operating Plan for FY2006 Is Unreliable for Ratemaking Purposes, Untested in this Proceeding, and Must Not Be Considered by the Commission in Its Deliberations.

A recent press release issued by the Postal Service discusses the new Fiscal Year 2006 operating and capital plans presented by Chief Financial Officer and Executive Vice President Richard J. Strasser, Jr.<sup>21</sup> The operating plan for the upcoming FY2006 points to changed circumstances and increasing costs in FY2006. However, the operating plan is an unreliable tool for ratemaking purposes and is not part of the record in this proceeding and must not be considered by the Commission in its deliberations.

OCA is reluctant to bring these updated estimates for the FY2006 to the Commission's attention at all, but it is necessary to make a couple of observations. First, the operating plans are, of course, not in the record in this proceeding. They have not been subjected to scrutiny either as to the purposes for which they were prepared or

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<sup>20</sup> Tr. 2/158 (OCA/USPS-T6-42b), Tr. 2/201.

<sup>21</sup> USPS News Release No. 05-079, September 27, 2005 at [www.usps.com](http://www.usps.com).

as to the underlying assumptions that may differ greatly from the assumptions underlying the costs and revenues estimated for this record.

Second, the press release cites an operating plan. Operating plans do not reflect estimates provided in the record for ratemaking purposes and would be entirely misleading if considered as a basis for estimating the future earnings in the FY2006 test year. For instance, in this proceeding the Postal Service specifically did not use the FY2005 operating plan estimate in the rate case. Witness Tayman's exhibits actually used much higher FY2005 net income figures than the incomes estimated in the FY2005 operating plan.<sup>22</sup> For instance, the budget estimated net income as of the end of FY2005 would be a loss of \$123 million.<sup>23</sup> The rate proceeding assumed net income as of the end of FY2005 to be \$1.64 billion.<sup>24</sup> The difference in the income estimates made only a few months apart was \$1.9 billion. The reasons for all of the differences between the operating plan income for FY2005 and the FY2005 estimate to support the rates in this case are unknown. However, one logical reason is that the estimates in the budget were compiled in the fall as they always are at the beginning of the fiscal year.<sup>25</sup> The rate case estimates for FY2005 were provided to the Commission about six months later, in April, 2005. It is important to realize rate case income estimates produced at a later time, as well as actual income, can be significantly greater and vary significantly

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<sup>22</sup> Tr. 2/145 (OCA/USPS-T6-31); Tr. 2/145.

<sup>23</sup> Tr. 2/121 (OCA/USPS-T6-13a).

<sup>24</sup> Exhibit USPS 6I Revised at Tr. 4/1123.

<sup>25</sup> Tr. 2/16 (OCA/USPS-T6-12).

from operating plan estimates gathered only a few months earlier. Suffice to say, the operating plan budget estimates do not provide a reliable source for the Commission.

This underestimation of actual earnings in the operating plan is not an isolated event. Similarly, in Docket No R97-1, the Postal Service's estimates of its income in the test year were persistently lower than the actual test year earnings reported during the proceeding. The Postal Service even continued to insist during the proceeding in the face of large profits of over \$1.1 billion toward the end of the year that, as estimated in the budget, dire events in the last couple of months would eliminate the earnings and lead to a \$1.2 billion loss.<sup>26</sup> In the actual event, that did not occur and the Postal Service ended the year with \$600 million profit.<sup>27</sup>

Circumstances do change continually. Despite some of the relatively negative news provided in the operating plan, Postmaster General Potter recently indicated only a few days before the report on the FY2006 operating plan that the "Postal Service is expecting a good first quarter of its fiscal year and hoping for legislation that gives it some relief of the escrow payment."<sup>28</sup> Accordingly, the actual needs of the Postal Service are in flux, and not the least important is the course of the legislation in Congress.

Third, reopening the record to recognize changed circumstances does not appear to be realistic. Obviously the supporting documentation for the new Postal Service operating plan estimates is not a part of this record. It is unlikely the

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<sup>26</sup> Opinion and Recommended Decision, Docket No. R97-1, May 11, 1998, at 35, 39, and 42.

<sup>27</sup> See Net Income for FY98. USPS 1998 Annual Report, at 72.

<sup>28</sup> Statement to National Postal Customer Council, Postcom Bulletin 37-05, September 16, 2005, See [<http://postcom.org/private/publications/bulletin/2005bulletin/BUL37-05.pdf> ]

Commission would be interested in moving down the slippery slope of updating the record to enter into evidence these new estimates. The impact of re-opening the record is one of opening a Pandora's box of new problems. Each cost segment and revenue source must be reviewed and recalculated to measure the influences of circumstances changed since the filing of this case. During Docket No. R2000-1, the Commission only reluctantly required an update of the record because it recognized the extensive modifications to the filing that were required to recognize actual data that had become available.<sup>29</sup> OCA does not suggest this alternative, but if the Commission wishes to consider the newer FY2006 operating plan, it must permit an updating of the entire record to recognize events since the rate request was prepared. Those events may or may not have been included in the Postal Service's assumptions and workpapers updating its FY2006 plan. Further hearings would be required to explore that issue.

- F. Unless the Commission Reduces the Rate Increase Or Takes Action To Encourage Delay Of the Rate Increase, There Is A Strong Probability Passage of the Proposed Legislation Will Allow the Postal Service to Reap Huge Profits Through Unnecessary Rate Increases Which Will Never Be Returned To Its Customers.

When the history of this entire rate proceeding is placed into its current context and viewed with a long lens as to its potential future impact, there is a very disturbing sense that mailers, in general, and the non-business First-Class mailers in particular, will be paying more for their mail than is either necessary or desirable for their postal service. The Postal Service initiated this proceeding only because of a potential escrow

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<sup>29</sup> "Order on the Use of FY 1999 Data," Docket No. R2000-1, May 26, 2000.

payment required by Public Law 108-18. To soften the blow of the increase, witness Potter stated (USPS-T-1, at 7):

Should legislation be enacted that relieves the Postal Service of this \$3.1 billion obligation before a recommended decision is issued in this docket, we will withdraw this request.<sup>30</sup>

The commitment is to withdraw the request “before a recommended decision is issued in this docket.” That appeared to be a reasonable and forthright statement. The Postal Service is placed in a difficult position. At the time of filing it seemed there was a good chance the legislation that withheld from Postal Service use \$3.1 billion of escrow payment would be revised to eliminate the escrow or at least make the provisions more equitable. After all, the \$3.1 billion represents amounts that were already overpaid into the retirement system. Surely, it seemed, the Congress would not require the customers to pay again for postal employee retirement benefits.

The Postal Service wanted to expedite this proceeding in order to get the across-the-board increase out of the way. It convinced many of the parties that it would be counter-productive to argue over divisive issues of cost allocation, attributions or costing methodologies. That would only delay the case and the chance to implement the rate increase needed for the escrow payment, and legislation might negate the increase anyway.

Legislation almost passed last summer that would have eliminated the double charge incurred by the escrow payment. Yet, just as the legislation was seemingly coming to a head, Postal Service Board of Governors sent a letter to Congress opposing the legislation.<sup>31</sup> The Postal Service has had the opportunity to oppose this legislation many times in the past, but apparently it has not objected as it did in the letter. Thus, the chance for legislation prior to Commission action now appears very slim. But, if the now delayed legislation passes after Commission action, new rates would be implemented that will not be needed for the escrow payment.

The situation is very troublesome for mailers. First, in its rate filing, the Postal Service never specifically addressed the matter of its new-found cumulative earnings. Second, the Postal Service bases its rate request upon the suggestion that unless the rates are increased debt will be incurred. Given the Postal Service's recent past history of almost unmanageable debt, this threat of further debt strikes all those who hear of it as a very plausible concern. Yet, it turns out the Postal Service paid off all of its debt long before (6 months before) the rate case was initiated but neglected to highlight that point in its filing. Moreover, further

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<sup>30</sup> Of course, witness Potter only speaks for management and not the Board, however, we must assume the Board would follow his recommendation in such a case.

<sup>31</sup> Letter to the Honorable Tom Davis, Chairman, Committee on Government Reform, September 13, 2005. Reported by PostCom, September 14, 2005.

inspection revealed that the debt required to meet the escrow payment, while of course undesirable, would not be a problem, even if there were no rate increase.<sup>32</sup> Also, there is no claim in this record that operations would be affected if the rates are not increased.

Furthermore, it turns out the escrow payment is not due until the very last day of FY2006, i.e. September 30, 2006. That is eleven months after October 31, 2005, the day by which the parties to the settlement may withdraw unless the Commission has issued its recommended decision.<sup>33</sup> Thus, if the legislation is not passed by the date of a Commission opinion around October 31, the Congress still has eleven months after that date to act responsibly and eliminate the obviously unfair and unnecessarily restrictive escrow payment. If that is done, then the rates the Postal Service is hastening to implement will not be necessary. Yet, in that case, the Postal Service has not even suggested it will attempt to provide relief for its customers. Not only does the Postal Service want to keep its \$2.58 billion of retained earnings, it would also have collected the new rates without purpose. One can only wonder why the Postal Service did not at least offer to withhold the rate implementation if legislation eliminating the escrow payment were passed before the implementation date of the proposed rates. Without putting too fine a point on it, if the proposed rates become effective on January

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<sup>32</sup> Tr. 2/156, 211.

1, 2005, and Congress eliminates the escrow payment, the Postal Service will increase its retained earnings by \$1.94 billion,<sup>34</sup> from \$2.58 billion at the end of FY2005 to a whopping total of \$4.52 billion of retained earnings on September 30, 2006. The Postal Service would also be debt free as of September 30, 2006.

Interestingly, the new legislation now apparently opposed by the Postal Service management permits retained earnings. However, that legislation establishes an entirely different regulatory and pricing regimen in which much of the business is placed in competition with other companies and where retained earnings would be appropriate. Pricing on the non-competitive side will continue to be regulated and the opportunity for earning profits will be limited. Thus, because retained earnings will be permitted, the Postal Service will never be required after the postal reform legislation becomes effective to return that \$4.5 billion through reduced rates, even though those amounts have been and would be collected at a time when retained earnings are not permitted by the PRA.<sup>35</sup> It is not likely that Congress is expecting the Postal Service to enter a new era of postal reform with \$4.5 billion of retained earnings already in hand.

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<sup>33</sup> USPS Init. Br., at II-15.

<sup>34</sup> A full year of new revenue will generate \$2.58 billion of revenue. Three fourths of that is \$1.94 billion. This was shown in OCA's Initial Brief at 29, note 51.

Thus, it appears the current situation, so far, has been managed cleverly by the Postal Service. It has expedited the Commission's rate procedures and obtained a settlement from most parties to insure the Commission acts before the escrow payment is eliminated. The management has now expressed misgivings that would delay the legislation. The Postal Service has not promised to return excess funds collected after the Commission action and it stands to reap a huge bundle of retained earnings when the needed legislation is passed—retained earnings it will never be required to return to its customers.

If legislation is passed during FY2006 before the escrow payment is due, the Postal Service's promise to review all these matters in the next rate case, including applying the breakeven requirement, becomes an empty one. Certainly a rate case to consider the treatment of retained earnings will be overtaken by events if the legislation is passed in FY2006. That legislation would remove the escrow payment but the new rates will remain in effect providing a windfall for the Postal Service. Moreover, the new legislation would permit retained earnings and therefore essentially moot the issue of treatment of retained earnings.<sup>36</sup>

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<sup>35</sup> The fact that the draft legislation includes a specific provision allowing for retained earnings is an indication Congress believes the current PRA legislation does not allow for retained earnings.

<sup>36</sup> Even if there is a "final" rate case under the current law of the PRA after passage of postal reform, and even though witness Potter said he would deal with the policy issue in the next rate case (Tr. 2/78), as a practical matter, returning that amount in the "final" rate case under current law for the benefit of ratepayers is not likely to be workable for such a large amount of retained earnings.

Even if the legislation is passed after the end of FY2006 and the Postal Service is required to pay the escrow amount into the trust, that money will not be lost forever to the Postal Service. At least some of the escrow funds will be available for Postal Service operations. Some of the escrow payment may go to the new health benefits fund, but it appears a large portion of the escrow would be retained by the Postal Service because the health benefits fund payments will be, apparently, lower than the escrow payment.<sup>37</sup> That money would go directly to the Postal Service's bottom line, thus contributing to the retained earnings already accumulated.

Unfortunately, the current system prevents a simple remedy for the Commission. The Postal Service is free to implement approved rate increases at any time within its discretion. The Commission is unable to condition its recommendation only upon the continued requirement to pay the escrow amount. Nor can the Commission delay implementation of the rates until it is certain they would be needed. This is a systemic problem. It requires the cooperation of the Postal Service. But this is a case of first impression. The Postal Service has not had any retained earnings before, let alone earnings of the potential magnitude involved. The time value of the \$4.5 billion alone would be a matter justifying a rate adjustment. OCA sees no evidence that the Postal Service will increase

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<sup>37</sup> See VP/USPS-T6-9.

rates only if the escrow payment is required. Passage of the legislation will virtually guarantee a significant increase in retained earnings above the \$2.58 billion the Postal Service has accumulated by the end of FY2005-- probably very close to \$4.5 billion in cumulative income by the end of FY2006. The Postal Service's customers will have very little likelihood of retrieving those amounts.

G. The Postal Service's Commitment In Its Strategic Transformation Plan To Post National Service Performance Data On The Usps.Com Website Is To Be Commended

The Postal Service's recently released Strategic Transformation Plan<sup>38</sup> speaks to the progress it has made in recent years improving service, and the strategic challenges and trends facing it with respect to future service improvements. In a chapter entitled, "Improve Service," the Postal Service identifies the challenge of providing postal customers with more and better information concerning postal services:

Customers are more likely to seek and compare information from a number of sources, increasingly using the Internet. They expect to be able to access information and manage their relationships with businesses, at least in part, on the Internet.<sup>39</sup>

As part of its plan to improve service, the Postal Service identifies delivery performance as "the single most important customer requirement and is very closely

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<sup>38</sup> *Strategic Transformation Plan, 2006-2010*, United States Postal Service, September 2005.

<sup>39</sup> *Id.*, at 55.

correlated with customer satisfaction.”<sup>40</sup> In order to help customers understand the quality of the delivery service performance being provided, the Postal Service states:

National service performance data will be posted on *usps.com* for First-Class Mail, Express Mail, and Priority Mail. The data will be posted on a quarterly basis.<sup>41</sup>

The Postal Service is to be commended for recognizing the importance of delivery performance data to postal customers, and making such data readily available on the Postal Service’s website.

### III. Conclusion

Aside from the issue of the legality of retaining earnings, there is every likelihood that the requested rate increase is premature at best and, at worst, will be unnecessary and will never be recovered by the ratepayers. For these reasons, and not only because the PRA does not permit a build-up of retained earnings, the Commission should reduce the exposure of mailers to premature postage and fees and recommend an increase of 0.8 percent across-the-board or obtain a binding Postal Service commitment to delay implementation of the rates until August 15, 2005.

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<sup>40</sup> Id., Appendix A, at A-1.

<sup>41</sup> Id.