

BEFORE THE
POSTAL REGULATORY COMMISSION
WASHINGTON, DC 20268-0001

RATE AND SERVICE CHANGES TO IMPLEMENT
BASELINE NEGOTIATED SERVICE AGREEMENT
WITH LIFE LINE SCREENING

Docket No. MC2007-5

**REPLY BRIEF OF THE
UNITED STATES POSTAL SERVICE**

UNITED STATES POSTAL SERVICE

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February 11, 2008

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I. INTRODUCTION

The United States Postal Service hereby submits its Reply Brief in this proceeding. This Reply Brief responds to the Initial Brief filed by the Office of the Consumer Advocate (OCA) and the Initial Brief filed by the American Postal Workers Union, AFL-CIO (APWU). The OCA and APWU were the only two parties to file an Initial Brief other than the co-proponents. In short, the OCA's arguments against the Life Line Screening NSA are not supported by the record evidence, and should be rejected because the OCA seeks to substitute its own business judgment for that of the Postal Service and its co-proponent. Additionally, APWU's speculative concerns are not sufficient to defeat this NSA. Therefore, the Postal Service respectfully urges the Commission to reject the arguments put forth by the OCA and APWU, and approve the Postal Service's request to implement the Life Line Screening NSA.

II. THERE IS SUFFICIENT RECORD EVIDENCE IN SUPPORT OF THE PROPOSED NSA, AND NO INTERVENOR HAS MADE A COMPELLING ARGUMENT AGAINST THE POSTAL SERVICE'S FINANCIAL MODEL

A. The OCA's Criticisms of the Postal Service's Financial Model Are Not Supported on the Record

The Office of the Consumer Advocate (OCA) follows a familiar strategy in its Initial Brief. Rather than submitting testimony of its own to try to demonstrate, on the record, how the Postal Service's financial model (in the OCA's view) improperly estimates the financial benefit from this NSA, the OCA relies upon a flawed argument pertaining to non-price exogenous factors in its Initial Brief. The OCA seems to argue that the Postal Service should control for every non-price exogenous factor imaginable in its financial model (presumably, up to and including "Acts of God"), but at the same

time the OCA has not offered any means of doing so on the record. The OCA essentially argues that the Life Line Screening NSA should be rejected simply because the Postal Service cannot *guarantee* that non-price exogenous factors will not occur in the future. This line of thinking is wholly unrealistic, as it ignores the Postal Service's ability to make rational business judgments in response to changing economic conditions, and it gives short shrift to the multiple risk-mitigation features inherent in the Life Line Screening NSA contract language.

1. The OCA's misleading argument about the standard of review for this NSA should be ignored by the Commission.

Despite the fact that the Life Line NSA was clearly submitted under the Postal Reorganization Act (PRA), the OCA asserts in its Initial Brief that the Life Line Screening NSA should meet a higher standard under the Postal Accountability and Enhancement Act (PAEA).¹ The APWU, the only other party to file an Initial Brief in opposition to this NSA, at least recognizes the basic fact that the PRA applies in this docket.² Amazingly, the OCA's Initial Brief contains dozens of references to the PAEA, and only mentions the PRA, the controlling statute in this case, once. The "transition rule"³ of the PAEA is wholly ignored.

¹ See OCA Initial Brief at 1-3.

² APWU Initial Brief at 4, note 15 ("The current NSA was filed during this transition year; therefore, the criteria of the Postal Reorganization Act apply.").

³ 39 U.S.C. § 3622(f).

The OCA's argument is primarily based upon the Opinion and Recommended Decision in the Bank of America NSA (Docket No. MC2007-1), in which the Commission concluded that:⁴

[T]he enunciated policies and objectives of [the PAEA] are both material and relevant, and that they should be applied under the aegis of "such other factors as the Commission deems appropriate." §§ 3622(b)(9) and 3632(c)(6).

From this statement, and the language of 39 U.S.C. § 3622(c)(10)(A), the OCA thereby concludes that the Life Line NSA *must* "improve the net financial position of the Postal Service" in order to be approved.

While the Commission has expressed its view that it may properly consider the PAEA as one of many "factors as the Commission deems appropriate," the OCA takes quite a leap in arguing that the Life Line NSA must be held to a new *requirement* under the PAEA, when this docket was clearly initiated under the PRA.⁵ In addition, as several parties pointed out in Docket No. RM2007-1, nothing in the PAEA or the Commission's rules support the OCA's view that the PAEA imposes a higher standard for NSAs.⁶ Moreover, the OCA seems to claim in its Initial Brief that the PAEA language is a well-developed statutory test, when in reality the parameters of §

⁴ PRC Op. and Rec. Dec., MC2007-1, at 52.

⁵ See OCA Initial Brief at 3 ("Consequently, the PAEA's first statutory test, which requires that an NSA improve the net financial position of the Postal Service, is alone applicable to the LLS NSA."); 39 U.S.C. § 3622(c)(10)(A).

⁶ See Reply Comments of the United States Postal Service in Response to Order No. 26 (October 9, 2007) at 17-20; Reply Comments of Time Warner Inc. in Response to Initial Comments on Commission Order No. 26 (October 9, 2007) at 25-27; Reply Comments of Advo, Inc. in Response to Proposed Regulations Establishing a System of Ratemaking (October 9, 2007) at 5-8; Direct Marketing Association, Inc. Reply Comments Pursuant to PRC Order No. 26 (October 9, 2007) at 1-3.

3622(c)(10)(A) have not yet been fully explored on the record in this, or any prior, docket. Surely, there will be adequate time and opportunities for parties to debate and litigate the scope of the new rules for NSAs under the PAEA. However, the OCA's attempt to interject a new PAEA "statutory test" at this point in the proceedings, when this case was submitted under the PRA, should be rejected.

This is not to say, however, that the policies behind the PAEA should be ignored. Rather, they can be considered as one of any number of "factors as the Commission deems appropriate." The Commission emphasized upon issuing regulations establishing a system of ratemaking (Docket No. RM2007-1):

[t]he statute seeks to provide the Postal Service with greater pricing flexibility for negotiated service agreements coupled with enhanced transparency and accountability. Requiring a specific formula or model for evaluating agreements is contrary to that intent." Order No. 43 at ¶ 2194.

And as Life Line Screening points out in its Initial Brief, the pricing flexibility afforded by the PAEA actually weighs in favor of approving this NSA. This argument can be found on pages 6-9 of Life Line Screening's Initial Brief, and need not be reiterated here. But introducing an unfounded statutory requirement to this proceeding, which has thus far not been a part of the instant litigation, would not be appropriate. Thus, the OCA's erroneous construction of the proper standard of review for this NSA should be ignored.

2. The OCA's concerns over non-price exogenous factors are without merit and are based on a flawed understanding of the Postal Service's financial model.

The majority of the OCA's Initial Brief is concerned with the effect of non-price exogenous factors on the Postal Service's financial model and the estimated financial

benefit to the Postal Service.⁷ The OCA asserts that the Postal Service has not controlled for the effects of non-price exogenous factors because it did not obtain or develop an elasticity of demand from Life Line Screening.⁸ This criticism, however, ignores the fact that there is no assurance on the record that any estimate of customer-specific elasticity in this case would be reliable.⁹ The OCA has offered no record evidence to demonstrate that such an estimate would in fact be reliable, yet is willing to point out that the absence of such an estimate is a flaw in the Postal Service's financial model because it would allegedly help control for non-price exogenous factors.¹⁰

The OCA spends eight pages of its brief attempting to show how the Postal Service's financial model is "flawed." However, six of those eight pages provide no citations to the record in this docket, save for one citation to an interrogatory response which refers to a quotation from Docket No. MC2002-2.¹¹ Essentially, the OCA is using its Initial Brief to offer its own untested economic theory regarding the effects of non-price exogenous factors and the supposed flawed assumptions in the Postal Service's financial model. Clearly, the OCA's argument is material which should have been submitted in the form of testimony, and should be subject to written cross-examination.

⁷ See OCA Initial Brief at 4-11.

⁸ *Id.* at 4.

⁹ This is a principle which the APWU, to its credit, recognizes in its Initial Brief. See APWU Initial Brief at 5 ("In today's environment it may be impossible for the Postal Service to develop mailer-specific elasticities.").

¹⁰ It is important to note that even with a precise and reliable estimate of customer-specific elasticity, non-price exogenous factors could still have an effect, yet would be controlled for (as they are in this case) by risk-mitigation provisions in the contract.

¹¹ OCA Initial Brief at 9, note 15.

Such theoretical musings with no basis in the record evidence have no place as the core argument in an Initial Brief.

Moreover, the OCA's argument with respect to non-price exogenous factors is based on a fundamental misunderstanding of the Postal Service's financial model. As explained by witness Parr¹² in the Bradford Group NSA: ¹³

[T]he methodology used to develop "OCA Exhibit 1" is conceptually flawed. Following long-standing PRC rate-litigation procedures, the financial model contained in my Appendix A is designed to use a before-rates and after-rates forecast which differ only by the volume effect of the proposed price change (in this case, the discounts on offer). Under these procedures, all other factors are assumed to be identical in the before-rates and after-rates forecasts. In a case where the assumed change due to price is zero, therefore, the before-rates and after-rates forecasts should be identical, and any assumed difference in a nonprice factor should be represented as an identical change to both the before rates forecast and the after-rates forecast.

Thus, the OCA's argument about the effects of non-price exogenous factors is in direct conflict with a fundamental assumption in the Postal Service's financial model; a financial model which has been approved in prior NSAs. In essence, the OCA urges the Commission to accept the OCA's own economic theory (untested on the record in this, or any prior, docket) in place of the Postal Service's financial model, which the Commission has approved in the past. When the actual record evidence is examined in this case, it is clear that there is no basis for OCA's concerns about the effects of non-price exogenous factors on the record.

¹² The OCA continuously cites record evidence from the Bradford Group NSA in its Initial Brief, rather than relying upon record evidence from this case. Thus, Postal Service refers to witness Parr's statement from Docket No. MC2007-4 because it demonstrates the OCA's misunderstanding of the Postal Service's financial model; a misunderstanding which apparently has carried through from Docket No. MC2007-4 to the instant docket.

3. The Life Line Screening NSA features several provisions which mitigate the risk of misestimating volumes and the effects of unforeseen events.

The Life Line Screening NSA contains several risk mitigation provisions, which have been present in prior NSAs. Nevertheless, the OCA attempts to tie its flawed argument about non-price exogenous factors to the risk mitigation provisions in the contract, simply concluding that these provisions are “irrelevant.” The risk mitigation provisions in the Life Line Screening NSA are summarized on pages 6-7 of the Postal Service’s Initial Brief, and need not be repeated in full here. But the importance of these provisions cannot be forgotten. The volume commitments require Life Line Screening to increase its mail volume before any discounts are paid out. In addition, the adjustment mechanisms allow the agreement to be adjusted in response to a change in circumstances from year to year. Finally, the automatic termination and unconditional withdrawal provisions grant the Postal Service protection from a variety of unforeseen events that may occur in Life Line Screening’s business, the mailing industry, and the economy as a whole, all of which may affect Life Line Screening’s volumes.

These risk mitigation provisions provide the Postal Service with a great deal of protection on a number of fronts, and give both parties the flexibility to adjust to changing circumstances. To label these provisions “irrelevant,” as the OCA does, is incomprehensible. The OCA’s argument completely ignores the Postal Service’s ability to make rational business judgments in the face of changing conditions. Thus, the OCA’s speculative concerns about the supposed prevalence of non-price exogenous

(...footnote continued)

¹³ Tr. 2/73-74 (OCA/USPS-T1-43(f)).

factors, and the claims that these factors are not “controlled for” in the proposed NSA should be rejected because of the presence of multiple risk mitigation provisions.

B. APWU’s Speculative Concerns Are Not Enough to Forestall Implementation of this NSA

The APWU, in its Initial Brief, states that it has “serious reservations” about the proposed Life Line Screening NSA.¹⁴ APWU indicates that it lacks confidence in the before rates volume estimates provided by Life Line Screening. Primarily, APWU relies upon the fact that Life Line Screening’s actual Standard Mail letter volume for FY 2007 was 106,267,407 pieces, which was higher than the original estimate. However, as the record evidence demonstrates, this unexpected increase will be offset because Life Line Screening plans to discontinue the operations of six vans in 2008.¹⁵ This will correspond to a decrease in roughly six to seven million pieces in 2008.¹⁶ The 2008 volume forecasts remain unchanged because the increase from Life Line Screening’s new affinity partner will be offset by the loss of vans.¹⁷

Nevertheless, APWU remarks that “there is no record of an evaluation of this impact, let alone evidence substantiating this understanding.”¹⁸ Yet APWU fails to recognize that the record evidence clearly states the impact of the loss of vans: namely, that it will result in a decrease of roughly six to seven million pieces in 2008. APWU apparently now desires additional substantiation of the record evidence, when it had the opportunity to request supplemental information via follow-up interrogatories, request a

¹⁴ APWU Initial Brief at 1.

¹⁵ Tr. 2/40-41 (APWU/USPS-T1-5-6).

¹⁶ *Id.*

¹⁷ Tr. 2/41-42 (APWU/USPS-T1-6-7).

hearing in this docket, or rebut this evidence through its own testimony. Therefore, all APWU can conclude is “the Postal Service *may be* discounting rates for mail that would have been sent regardless of rate incentives. *If true*, this NSA *would be* inconsistent with applicable statutory criteria.” (emphasis added).¹⁹

This kind of speculation is simply insufficient to counsel against approving this NSA. The APWU’s argument, much like the OCA’s argument, ignores the risk mitigation provisions in the contract that provide the Postal Service with protection against unforeseen events, and provide both parties the flexibility to adjust to changing circumstances. Moreover, the APWU ignores significant portions of the Postal Service’s direct case. Witness Yorgey performed company-specific research and volume trend analysis, and analyzed the market in which Life Line Screening operates.²⁰ Additionally, the Postal Service provided USPS-LR-L-1, which shows that the proposed NSA satisfies the “Panzar” test.²¹ The APWU’s Initial Brief focuses on the “Panzar” analysis put forth in the Bank One Reconsideration, yet does not offer any specific critique of the Postal Service’s own execution of this analysis in USPS-LR-L-1. In short, APWU’s Initial Brief solely offers speculative concerns about Life Line Screening’s volume estimates and the Postal Service’s financial model, while ignoring key components of the Postal Service’s direct case. An analysis of the actual record

(...footnote continued)

¹⁸ APWU Initial Brief at 4.

¹⁹ APWU Initial Brief at 4.

²⁰ Direct Testimony of Michelle K. Yorgey on Behalf of the United States Postal Service, USPS-T-1, at 7-8 (August 8, 2007).

²¹ USPS-LR-L-1, MC2004-3 Opinion and Further Recommended Decision Analysis for the Life Line Screening NSA, Docket No. MC2007-5 (August 8, 2007).

evidence in this docket, however, demonstrates that APWU's speculative concerns are not enough to forestall implementation of this NSA.

III. CONCLUSION

The OCA attempts in its Initial Brief to impose a new requirement that the Postal Service must predict the future with certainty, and guarantee that non-price exogenous factors will never affect this NSA. The OCA's argument ignores the multiple risk-mitigation features in the contract, as well as the Postal Service's ability to make rational business decisions in the face of unforeseen events or changing circumstances. Certainly, the OCA's view does not afford the Postal Service the degree of pricing flexibility that Congress intended under the PAEA, much less the ability to utilize basic business judgment under the PRA. In addition, APWU offers nothing more than speculative concerns in its Initial Brief, which should not prevent the implementation of this NSA.

For the reasons set forth above, and in the Postal Service's Initial Brief, the Postal Service respectfully urges the Commission to recommend the proposed NSA and adopt the classification language and rates set forth in Attachments A and B to the Postal Service's Request.

Respectfully submitted,

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