

In its Initial Comments on related points, Valpak suggested that the Postal Service be required to explain costs that vary from the CPI by more than 5 percentage points and provide results both **before and after** the correction of any errors. Valpak Initial Comments, pp. 18 and 21-22. MMA's comments, although limited in scope, likewise seek clarity regarding the sources of cost changes. Valpak supports MMA's quest for transparency regarding critical changes in costs.

II. The Public Representative

A. Projected Revenues and Expenses

The Public Representative ("PR") recommends that the Commission's proposed rules be amended to include a requirement for the Postal Service to submit a comprehensive projection of revenues and expenses for the current year. PR Initial Comments, pp. 3-6. In support of this recommendation, the PR says:

Obviously, current year projection data are already available since the Postal Service must prepare long-term as well as short-term projections for its budgetary and planning process.... Accordingly, any burden on the Postal Service to prepare such information for submission to the Commission should be *de minimus*. [PR Initial Comments, p. 5]

It appears that the Public Representative's proposal, which would require submission of a comprehensive current year projection, would force the Postal Service to incur unnecessary expense. Nevertheless, this proposal points out a potentially important gap in the Commission's proposed rules with respect to one type of data.

The PR is unquestionably correct that the Postal Service makes internal projections. However, because they are internal, persons outside the Postal Service currently have no knowledge concerning the assumptions which underlie these projections. Even if an outsider had access to the projections, without an explicit explanation of the many assumptions that underlie such an internal projection (*e.g.*, volumes, rates, deployment of new equipment, workload factors, costs, etc.), its internal projection for the current year would be of little value.¹ Moreover, the Postal Service's reply comments are likely to point out that its internal plans constitute a confidential component of its managerial discretion.²

The PR goes on to state:

These current year projections **should presume** current rates are in effect for the entire year.... There is no interest in interfering with Postal Service discretion regarding the timing of rate increases, nor is there any intent to force the Postal Service to disclose their internal planning regarding the next rate change. [PR Initial Comments, p. 6 (emphasis added).]

¹ Under the Postal Reorganization Act of 1970 ("PRA"), each rate case featured detailed roll-forward projections out to Test Year, and that exercise was replete with assumptions designed to keep projections for each successive year up to date and make them as realistic as possible. Under PAEA, the roll-forward exercise has been rendered obsolete by the requirement that rate increases not exceed the applicable cap and by the retrospective compliance review, and Valpak sees no need to resuscitate comprehensive roll-forward projections, not even for one year.

² On this point, the Postal Service's Initial Comments state that "[i]t is vital for the Postal Service to maintain control over the ability to forecast its own future, just as it would be for any large and complex business enterprise, and the Postal Service does not contemplate relinquishing control over its internal forecasting function." Postal Service Initial Comments, p. 26.

However, it does not appear the Public Representative is asking the Postal Service to submit the **readily available** internal projections, but instead to prepare **an entirely new projection**, different from that which is being used by the Postal Service internally for its budget planning.

The Postal Service's Initial Comments anticipated proposals such as that suggested here. The Postal Service sees no need for it to incur the expense of preparing and submitting a projection, albeit "simplified," for the current year, and recommends that the Commission not adopt any such rule, citing 39 U.S.C. section 3652(e)(1):

"[T]he Commission shall give due consideration to— ...
(B) avoiding unnecessary or unwarranted administrative effort
and expense on the part of the Postal Service...." [Postal
Service Initial Comments, p. 3.]

The Public Representative's Initial Comments are useful in that they demonstrate how the proposed rules focus almost exclusively on the just-ended year under review — and that very little information is required about the current year outlook for any product. This is surprising in view of the Commission's statement in Order No. 104 that "the Commission will need forward looking as well as historical information to ... evaluate ... financial prospects." Order No. 104, p. 4. Certainly, there is at least one area where current year information would be important, as described below.

The Commission's Annual Compliance Determination for FY 2007 reported a total of seven postal services not covering their attributable costs. *See generally* Valpak Initial Comments, pp. 38-40. Although the Commission took no action then in a transitional review period, should any future annual compliance report by the Postal Service again document that one or more postal products failed to cover attributable costs for the year under review, then

such products, as well as rates for those products, clearly would have failed to comply with all applicable requirements of Title 39, and Commission action would be required.

Hopefully, the situation hypothesized above will not arise. However, should it occur, then for each product that fails to cover its attributable costs, the proposed rules should require the Postal Service to: (1) provide a projection of revenues and attributable costs for the current year, (2) discuss the feasibility of all critical assumptions underlying the projection, and (3) explain how each such product complies with all applicable requirements of Title 39.

Unless the Postal Service can show with reasonable credibility that documented non-compliance during the year under review will not recur in the current year, that circumstance presumptively should warrant a written determination of non-compliance by the Commission, together with appropriate remedial action.

B. Timing of Public Representative's Appointment

The Public Representative's Initial Comments also include a recommendation to include in the final rule provision for the appointment of a Public Representative with respect to the Commission's consideration of a change in an analytical principle as soon as possible. *See* PR Initial Comments, p. 7. This proposal highlights some of the problems that could be eliminated if the Commission were to return to its former practice of maintaining an ongoing Officer of the Commission to represent the interests of the general public as was suggested by Valpak both in its Initial Comments in this docket, and its Initial Comments in Docket No. RM2008-3. If the Commission had such a permanent Officer of the Commission, not only would it be able to participate in changes in analytical principles suggested by the Commission,

the Postal Service, or other parties, but such officer also could petition the Commission to initiate a rulemaking proceeding.

III. U.S. Postal Service

The following comments relate to certain of the 12 comments made by the Postal Service in its Initial Comments. The Postal Service's numbering system and section headings are maintained in the section below. As discussed *infra*, Valpak's position on a particular issue may differ from the position articulated in the Postal Service's section heading.

1. "Rules for USO-Related Reporting and SEC-Related Reporting Should be Deferred." (pp. 4-14)

The Postal Service recommends that universal service obligation ("USO") related reporting rules be deferred until after the Commission's and the Postal Service's reports on the USO have been completed, and then assessing what data the Commission needs to fulfill its obligation under section 3651 of Title 39. The Postal Service offers a criticism of data required by proposed Rule 3050.30(c)(2) and (d)(1), questioning whether the Commission really needs "stop" information from the CCCS and RCCS surveys.

Valpak agrees with the Postal Service's suggestion that rules on USO-related reporting be deferred until after the relevant studies have been completed and, minimally, subjected to review and comment by interested parties. Additionally, Valpak suggests that, after the USO studies have been completed by the Postal Service and the Commission, the Commission conduct a strategic rulemaking on this topic. *See, e.g.*, Order No. 104, pp. 32-33. A strategic rulemaking docket would enable the Commission, the Postal Service, and other interested

parties to consider in a collaborative setting the implications of those studies on the ongoing reporting obligations of the Postal Service, and would assist the Commission in designing those obligations.³

2. “The Placeholder Approach is Also Appropriate to Address the Obsolescence Issues Currently the Subject of Proposed Rule 3050.12.” (pp. 14-22)

The Postal Service describes the requirement to report on and update studies that are more than five years old as “decidedly arbitrary.” Postal Service Initial Comments, p. 19. It proposes that Rule 3050.12 be deleted or suspended, and in lieu thereof it suggests having “a separate proceeding such as a strategic rulemaking” to consider what needs to be done. *Id.*, p. 20.

Although Valpak initially supported that the proposed rule provided a timetable for updating studies (Valpak Initial Comments, p. 36), Valpak finds merit in the Postal Service view that a placeholder could be substituted temporarily for proposed Rule 3050.12, which would allow the entire matter to be considered within the context of a strategic rulemaking, as proposed by the Postal Service. Postal Service Initial Comments, p. 20. Valpak supports the Postal Service suggestion that the Commission convene such a strategic rulemaking not only to consider priorities for updating old studies, but also to consider new studies where none now exist.

³ Additionally, a strategic rulemaking could address the proposal of the Greeting Card Association to expand proposed Rule 3050.30 to require additional information on revenue collected by rural carriers. *See* Greeting Card Association Initial Comments (October 16, 2008), pp. 1-3.

In its Initial Comments, the Postal Service reports that it updates annually a number of databases critical to a variety of studies.⁴ This is admirable, but at the same time, the Postal Service has allowed some matters to fall between the cracks. For example, nowhere does it mention that in the 38 years during which the Postal Reorganization Act of 1970 was effective, the Postal Service never developed a distribution key for Vehicle Service Driver costs based on actual data. In the absence of actual data, the Postal Service used RPW volumes as a proxy. In Docket No. RM2008-2 on Costing Methodology, in the absence of a distribution key based on actual data, the Postal Service recently proposed to substitute a new proxy, admittedly imperfect, for the existing proxy. This clearly is an example of one study that never has been done, as of this date. There may well be other similar examples.⁵

The point here is that when no study whatsoever exists, the term “obsolete” in describing the study obviously is not an apt description. The danger of Rule 3050.12 as proposed is that, in focusing attention exclusively on studies more than five years old, it neglects those total voids where no prior study exists. Study resources are limited, and resources capable of updating old studies also can be directed to new studies designed to fill existing voids. An entirely new study may be more important than updating some study that is

⁴ *E.g.*, “The cost accounts are updated every year, and the inputs from the major data systems (IOCS, CCCS, RCCS, etc.) are updated every year.” *Id.*, p. 16.

⁵ *See, e.g.*, Time Warner Initial Comments, Docket No. RM2008-2, which include an attachment suggesting a number of studies dealing with the cost of handling periodicals. Some of Time Warner’s suggestions represent updates of existing studies, whereas others call for entirely new studies.

more than five years old. Particularly in light of this consideration, Valpak supports the Postal Service suggestion of a strategic rulemaking to consider the subject in such a broader context.

5. “The ACR Reporting Rules for Negotiated Service Agreements Can Be Improved with Minor Modifications.” (pp. 32-37)

With respect to reporting on negotiated service agreements (“NSAs”), the proposed rules would require the Postal Service to:

Analyze the contribution of the agreement to institutional costs for its **most recent year of operation**. The year analyzed shall end on the anniversary of the negotiated service agreement that falls within the fiscal year covered by the Postal Service’s Annual Report and include the **12 preceding months**. [Proposed Rule 3050.21(f)(4) (emphasis added).]

The Postal Service suggests that it be allowed the option of reporting the contribution from NSAs on “either [i] a fiscal year basis or on [ii] the most recent year of operation,” explaining that “[b]uilding this flexibility into the rule could result in reporting procedures that are more efficient for both the Postal Service and the Commission.” Postal Service Initial Comments, p. 36.

Valpak agrees with the Postal Service proposal, believing that allowing it to report contribution from NSAs on a fiscal year basis actually could facilitate analysis of the information presented.

6. “Because Additional Resources Would Be Necessary to Allow the Postal Service to Produce Billing Determinants Every Quarter, Which Outweigh Any Benefit of Such Data, That Proposed Requirement Should be Dropped.” (pp. 37-39)

Proposed Rule 3050.25(d) would require submission of **quarterly** billing determinants. The Postal Service opposes this rule, and points to the necessity for “expenditure of additional resources,” the “extraordinary effort” required to meet a 40-day deadline, the prospect of “never-ending ... billing determinant production routines,” and revisions required to align the quarterly figures with final annual figures. Postal Service Initial Comments, pp. 37-38.

Billing determinants cover all postal products and special services. Inputs come from a wide range of places and systems, and the attention of analysts is required to develop and verify the report. Valpak agrees with the Postal Service that it would be desirable to avoid any unnecessary cost, and that generating complete quarterly billing determinants appears to be unnecessary. At the same time, much or all of the information needed for the major market dominant categories of, say, First-Class Mail, Periodicals, and Standard Mail, particularly the bulk categories, likely is now generated, or could be generated, automatically by the RPW system and the associated systems that feed into it, and this information could be presented quarterly.

To the extent that there might be developing trends of which the Commission needs to be aware on a quarterly basis, the relevant data almost surely would pertain to these major categories, not special services and smaller products. Certainly, the Commission and mailers would understand and accommodate the possible need for conforming revisions at the end of the year. Accordingly, Valpak suggests that the Commission publicly inquire of the Postal

Service whether quarterly billing determinants could be developed for limited major categories, specifically bulk categories, without undue effort and expense.

7. **“SEC-Type Reporting Supplants Certain Previously-Provided Periodic Reports as the Vehicle by Which the Objective of Appropriate Transparency is Best Achieved.”** (pp. 39-41)

With respect to proposed rules pertaining to SEC-type reporting requirements, the Postal Service’s comments include the following:

In addition to quarterly Form 10–Qs, however, the proposed rules (in section 3050.28) would also require **monthly** submission of the National Consolidated Trial Balances (NCTB) and the Revenue and Expense Summary (RES).... The NCTB and RES reports contain **large amounts of very specific financial information**, but **provide no guidance** in terms of **how to interpret the raw data** to understand the **“big picture.”**... The SEC-type reporting requirements of section 3654 demonstrate a Congressional preference for the quarterly disclosure of data in order to ensure transparency. Reporting on more frequent intervals is unnecessary. [Postal Service Initial Comments, p. 40 (underline original) (emphasis added).]

Valpak agrees with the Postal Service that it is not necessary to provide mailers with monthly financial data of the type found in the NCTB and RES reports, but takes no position on whether monthly NCTB or RES reports are needed by the Commission. Valpak is in full agreement, though, with the Postal Service’s observation that large submissions of data, submitted without meaningful explanatory material, provide “no guidance” and do little to promote transparency by understanding the “big picture.”

The Postal Service’s observations here about difficulty of understanding raw NCTB and RES data apply equally to Postal Service spreadsheets that are full of detailed cost data and, at

best, may be accompanied only by a few notes. *See* Valpak Initial Comments, pp. 15-17 and 41-42. If mailers are not allowed a meaningful opportunity to conduct discovery about costs that appear out of line, or anomalies in cost data, then it becomes even more important for the Postal Service to provide narrative information in its annual compliance report which begins the annual compliance review. *See* Annual Compliance Determination, Docket No. ACR2007, Principal Findings, p. 3; *see also* Valpak Initial Comments, pp. 4-8.

10. “The Capabilities of An Incremental Cost Model Must be Kept in Perspective.” (pp. 45-47)

Proposed Rule 3050.23 would require the Postal Service to produce estimates of incremental costs. The Postal Service’s Initial Comments state that:

[T]he Postal Service anticipates that it can provide incremental cost estimates starting in FY09 ... [but] very large products can create practical issues for incremental cost estimation

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The incremental cost for a product or group of products is the **additional cost incurred** by an enterprise that arises because of the **addition of** that product or group of products.... [T]he calculation of incremental cost takes as its starting point the ongoing actual operations of the enterprise.... [T]he calculation of incremental cost for a very large product or group of products is more difficult, because it requires assuming that the ongoing operations for the remaining smaller products **remains the same** in the **absence of** the large product group or group of products. [Postal Service Initial Comments, pp. 45-46 (emphasis added).]

First, Valpak appreciates the Postal Service indicating that it expects to provide estimates of incremental costs in FY2009. Developing reliable estimates of incremental costs will require considerable effort, as Valpak recently noted. *See* Valpak Initial Comments, Docket No. RM2008-2, pp. 9-10.

Second, we note what appears to be a slight inconsistency. Namely, if “calculation of incremental cost takes as its starting point the ongoing actual operations of the enterprise,” then the incremental cost of **any existing** product or group of products is the **reduction** in cost that would result in the **absence of** that product or group of products, regardless of whether the product or group of products in question is large or small. When the starting point is the ongoing actual operations of the enterprise, as postulated by the Postal Service, the **only** time that incremental cost will be the **additional cost incurred** is when the Postal Service **adds a new product** that is not part of ongoing operations. When estimating the incremental cost of **any existing** product or group of products, whether large or small, an almost exclusive focus on volume variable costs is not sufficient. Removing either a small or large product from the vector of products currently being produced may enable some institutional costs to be avoided.⁶ Accordingly, in addition to volume variable costs, **all existing institutional costs** of the enterprise need to be examined carefully to see whether they would diminish in the **absence of** the product or group of products in question.⁷

One of the more important distinctions between incremental and marginal cost is that **incremental cost** may include various costs that are considered to be **non-volume variable** (*i.e.*, institutional) and therefore are excluded from **marginal cost**. In Docket No. RM2008-2, under its Proposal One, Procedures for Identifying and Applying Group-Specific Costs, the

⁶ Any reduction in institutional costs that would be caused by the absence of one or more products can be considered costs avoided from restructuring.

⁷ Introduction of a new product would not require such an examination of existing institutional costs, although it would require looking at any fixed costs of the new product.

Postal Service has indicated it plans to undertake an exercise that will probe the nature of institutional costs contained in cost segments 16, 17, 18, and 20.⁸ As this exercise documents relationships between institutional costs and products or groups of products, there may need to be “moderate or substantial refinement in the [incremental cost] models going forward,” as the Postal Service acknowledges in its Initial Comments (p. 47). Unfortunately, an established methodology for determining whether institutional costs are incremental to any product or group of products does not exist, hence one must be developed.⁹ In light of this consideration, in its Initial Comments, Valpak suggested that the Commission convene a strategic rulemaking to consider studies designed to develop an appropriate methodology for estimating incremental cost. *See* Valpak Initial Comments, p. 43. For the reasons stated *supra*, we reaffirm that suggestion here.

Third, for **any existing** product or group of products, “**incremental cost**” is defined in the relevant economic literature as: the **reduction** in cost that would result **in the absence** of the product or groups of products **after any reconfiguration** of the operations of the enterprise necessary to achieve efficient operations. This definition of incremental cost applies to any

⁸ *See* Notice of the United States Postal Service Regarding Expanded Scope for Proposal One of the Requested Methodological Change for the FY08 ACR — Errata (Sept. 5, 2008), Docket No. RM2008-2.

⁹ In Docket No. RM2008-2, with respect to the Postal Service’s Proposal One, the Commission expressed concern about the lack of identifiable causation in the approach described by the Postal Service, and gave advance approval “to categorize an activity as group specific if it unambiguously supports only one product group ... because the decision rules to be applied are not known in advance, and a plan is not in place to analyze all relevant activities for group causation in a balanced way, the Commission cannot approve the results of such analyses before it, and the public, have had a chance to review the process, including the standards used and the manner in which they are applied.” Order No. 115, pp. 9-13.

product or group of products, whether large or small.¹⁰ The Postal Service Initial Comments are at odds with the requirement for restructuring when they state that preparing an estimate “**requires assuming** that the ongoing operations for the remaining smaller products **remain[] the same.**” To the contrary, preparing an estimate requires recognition that the Postal Service will restructure itself to produce efficiently the products that remain.

The Postal Service nevertheless is correct in stating that “very large products can create practical issues for incremental cost estimation.” Quantifying gains from restructuring is not easy, and removal of large products would be more likely to require extensive (hypothetical) reconfiguration than would the removal of smaller products. As the Postal Service itself indicates, the assignment can be “technically difficult.”¹¹ Postal Service Initial Comments, p. 46.

¹⁰ See, e.g., Direct Testimony of John C. Panzar on Behalf of United States Postal Service, USPS-T-11, Docket No. R97-1, pp. 8-11; see also Docket No. RM2008-2, Valpak’s Comments Regarding Costing Methods Used in Periodic Reporting, pp. 3-5.

¹¹ It may not be reasonable to estimate costs under restructuring by using a translog (or any other) equation fitted to current and recent operating data. Especially when a high volume product is removed, the new operating position will not be near the current operating position. For this reason, the Postal Service states:

It is not uncommon to be comfortable with the accuracy of the measurement of the slope of the cost curve in an area around the current level of production, but somewhat uncomfortable with the accuracy of that measurement some distance away from the current experience.... This is particularly true for flexible functional forms such as the translog. [Postal Service Initial Comments, pp. 46-47 and fn. 13.]

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