DOCKET SECTION

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

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POSTAL RATE AND FEE CHANGES, 1997	)	Docket No. R97-1

**RESPONSE OF MAJOR MAILERS ASSOCIATION
TO NOTICE OF INQUIRY NO. 5
ON RECOGNIZING INTERIM YEAR RESULTS**

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February 13, 1998

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Major Mailers Association (MMA) submits these Comments in response to the Commission's Notice of Inquiry No. 5. That Notice asks whether the Commission should recognize actual 1997 Postal Service income in developing rate recommendations in this case and, if so, how.

I. SUMMARY

The Postal Service's 1997 profit of $1.3 billion dollar illustrates how actual facts can invalidate a Postal Service filing that projected financial results two years past actual experience. The Commission cannot lawfully ignore the Service's 1997 windfall that has caused the Service's projections to become outmoded and misleading.

There is a need to "true-up" the Service's projections so that they take account of actual events. Though a perplexing task, this can be accomplished consistently with the *Newsweek* decision.

II. THE COMMISSION MUST TAKE ACCOUNT OF THE THE SERVICE'S 1997 ACTUAL $1.3 BILLION PROFIT THAT CONTRADICTS THE SERVICE'S PROJECTIONS

The Service's financial projections--which are projected *two years* past actual data--are especially vulnerable to being contradicted by actual data that make those projections "outmoded and misleading." (Cf. *In Re Central Vt. Pub. Serv. Corp.*, 449 Atl.2d 904, 908 (Vt. Sup. Ct. 1982).) When actual experience contradicts such projections, as it has here, a commission would be mistaken in ignoring those facts. "Extraordinary situations affecting test year results may be taken into account by reasonable adjustments" (*Boston Gas Co. v. Dept. Of Pub. Util.*, 269 N.E.2d 248, 263 (Mass. Sup. J. Ct. 1971)). For "the substitution of fact for prophecy at any point in the process of rate making is an advance on the road to certainty" (*Central Me. Power Co., 136 Atl.2d 726, 734 (Me. Sup. J. Ct.* 1957).

As Mr. Justice Cardozo said for the Supreme Court in an analogous situation (*West Ohio Gas Co. v. Comm'n*, 294 U.S. 79, 81-82 (1935):

> "The earnings of later years were exhibited in the record and told their own tale as to the possibilities of profit. To shut one's eyes to them altogether, to exclude them from the reckoning, is as much arbitrary action as to build a schedule upon guesswork with evidence available. There are times, to be sure, when resort to prophecy becomes inevitable in default of methods more precise. At such times, "an honest and intelligent forecast of probable future values made upon a view of all the relevant circumstance" [citations] is the only organon at hand, and hence the only one to be employed in order to make the hearing fair. But prophecy, however honest, is generally a poor substitute for experience. [citation]....A forecast gives us one rate. A survey gives another. To prefer the forecast to the survey is an arbitrary judgment

III. THE COMMISSION NEEDS TO "TRUE-UP" THE OUTMODED TEST YEAR EITHER BY HAVING THE SERVICE UPDATE THE TEST YEAR OR, IF IT REFUSES, BY USING A PROXY TO MAKE UP FOR THE UNDERESTIMATE OF PROFIT

Since the Service constructed its test year (1998) by rolling the intermediate year (1997) forward, any gross underestimate of 1997 profit creates an error in the test year. That gives rise to the question, posed in the Notice of Inquiry, about what "methods...would be appropriate for reflecting that information" about "actual 1997 Postal Service net income."

Certainly the Commission can ask the Postal Service if it is willing to update its test year to reflect "that information." Such a Comission request for an update would not be extraordinary. Other commissions have insisted that regulated companies update their test year. (See *Re United Gas Pipeline Co.*, *38* P.U.R.3d 209, 213 (La. PSC 1961).) Indeed, the Federal Energy Regulatory Commission has a regulation requiring certain test year data to be updated with actual data after the end of the historic, or past-data, test period (18 C.F.R. §154.311).

In reality, the Service should not find such updating to be a daunting task. The Service provides its Board of Governors with regular and periodic updates of financial projections. Despite this, for tactical reasons, the Service is likely to refuse to perform an update on the alleged grounds that it is unnecessary, burdensome or will result in delay. But if the Service adopts that tactic, the Commission will not be obliged by due process to blind itself to the "new information" and to adhere to the Service's now-discredited test year. *Cf. Market Street Railway Co. v. Railroad Comm'n*, 324 U.S. 548 (1944). Instead, the Commission will be justified in using a less-than-perfect proxy to

"true-up" the Service's test year projection.

One possibility is to ask the OCA (and any party that wishes) to prepare an adjusted test year projection. Another option is for the Commission to prepare a library reference. In either event, the Postal Service can be given an opportunity to point out errors and offer corrections during a rebuttal phase.

Another possibility is for the Commission to treat the unquantified increase in the Service's test year net income as a substitute for a contingency allowance. The Commission knows with certainty that the Service's net income for the interim year (1997) exceeded the Service's projection by $628 million; and that the Service rolled its inadequate projection forward to the 1998 test year. If the Postal Service refuses to quantify the effect of this error on the test year, the Commission would be justified in invoking the legal rule that--where a party refuses to divulge information within its knowledge and control--the inference is that the information would be unfavorable to it.[1] That inference suggests that the revenue understatement for the test year (1998) is of the same magnitude as in the $628 million understatement rolled forward from the

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[1] "It is very generally held that, where [one] party... possesses positive and complete knowledge concerning the existence of facts...or has peculiar knowledge or control of evidence of such matters, the burden rests on him to produce the evidence, the negative averment being taken as true unless disproved by the party having such knowledge or control." 31A C.J.S., Evidence §113 (1964) (citations omitted). "In the absence of explanation, the failure or refusal of a party to produce evidence may create an adverse inference where such evidence is within his knowledge, and where, the courts have declared, the evidence which the party fails or refuses to produce is within his power to produce, is not equally accessible to his opponent, and is such that he would naturally produce it if it were favorable to him." Id. at §156(1) (citations omitted). Accord, 2 Wigmore on Evidence §§285-91 (Chadbourne Rev. 1979); Jones on Evidence §3:91 (1972).

interim year (1997). That would mean that the test year error equals or exceeds the Service's requested $605.5 million contingency allowance. In that event, the Commission could treat the underestimate of test year net income as a proxy for a contingency allowance, eliminating the need for a separate allowance.

The Commission could make such an adjustment without running afoul of the Court of Appeals decision in *Newsweek*.[2] In that decision, the Court overturned the Commission's reduction of the requested contingency allowance, holding that the Commission's action was "arbitrary" and "an unlawful intrusion into the policy-making domain of the Board" (663 F.2d at 1205). But the Court was characterizing a Commission disagreement with the Governors about the needed *size* of the allowance. In contrast, in this 1997 Rate Case, the Commission would not be disagreeing about the needed size of the contingency. It would only be saying that the dollars for the contingency are provided in effect by correction of an error in the Service's projection of test year income.[3] The Commission would thus not be denying the Service its $605.5 million contingency, but only refusing to give it those dollars twice.

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[2] Newsweek, Inc. v. United States Postal Service, 663 Fed.2d 1186, 1203-05 (2d Cir. 1981). The Supreme Court affirmed the Court of Appeals decision, but the Court was not reviewing the portion of that decision that struck down the Commission's revenue reductions. National Ass'n of Greeting Card Pubs. v. USPS, 462 U.S. 810 (1983).

[3] The Commission has always held that it has authority to adjust the Service's cost of service in order to correct errors in the Service's estimates. *See* R71 Op., mimeo page 24 ("[I]t is essential that the cost and revenue estimates submitted by the Postal Service be subject to review by the Commission"). *See also Id.* at 13-24.

IV. The Service Cannot Argue That the Commission Must Ignore the Actual 1997 Net Income On the Grounds That It Occurred Before the New Rates Go Into Effect

The Service may be tempted to argue that the Commission should ignore the 1997 windfall because it occurred in the past, before the date of the test year or the date when the new rates go into effect. If a conventional public utility made such an argument, it would rely upon the rule that it cannot increase rates for the future in order to compensate for past losses;[4] the correlative is that future rates should not be reduced for past profits. But the Postal Service can and does compensate itself for past losses by means of the statutorily-sanctioned allowance for prior years' losses. The Service therefore has no claim to the 1997 windfall as compensation for sub-par earnings in earlier years.

V. TESTIMONY

The Service does not need MMA to calculate the correction in the Service's test year. MMA witness Bentley will be available at the March 3 hearing, however, in the event that the Commission wants to explore rate recommendations that would follow from various reductions in the Service's revenue requirement.

Respectfully submitted,

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[4] *See Board of Pub. Util. Commrs. V. N.Y. Teleph.* , 271 U.S. 23, 31 (1926); 64 A. Jur.2d §199 (1972).

CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing document, by First-Class Mail. upon the participants in this proceeding.

February 13, 1998

Jeffery Plummer