USPS-RT-11

BEFORE THE
POSTAL RATE COMMISSION
WASHINGTON DC 20268-0001

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

REBUTTAL TESTIMONY OF

M. RICHARD PORRAS

ON BEHALF OF

UNITED STATES POSTAL SERVICE

CONTENTS

Rebuttal Testimony

of

M. Richard Porras

AUTOBIOGRAPHICAL SKETCH

My name is M. Richard Porras, and I am Vice President, Controller, for the United States Postal Service. I have held the Controller position since March 1986; my previous title was Assistant Postmaster General, Department of the Controller. My responsibilities include the establishment, direction and control of the financial management operations of the Postal Service, including budget, payroll, accounting systems and operations in the Accounting Service Centers. I also direct the Postal Service's capital investment program. I received a Master's Degree in Business Administration from the University of California at Los Angeles. I have completed the Advanced Management Program at Harvard University. I began my career with the Postal Service in 1963 as a post office clerk in Los Angeles, California. I was selected as a management trainee in 1970, and subsequently served as a general foreman of mails, Manager of Accounting and Reporting Systems, and Director of Finance. I then served as General Manager of the Budget and Cost Division in the Postal Service's Southern Region, Regional Director of Finance in the Northeast Region, and District Manager of the Northern New Jersey District. I have also served in detail assignments as Officer-in-Charge of the Bronx, New York, Post Office and as Regional Director of Customer Services in the Northeast Region. I have represented the Postal Service in Exchange Programs with the Federal Republic of Germany since 1984 and with the Japanese Post since 1992. In October 1994, I was named Chairman of the Postal Development Action Group, an international committee of the Universal Postal Union.

I. PURPOSE OF TESTIMONY

Dr. John Stapert, testifying on behalf of the Coalition of Religious Press Associations, has characterized the Postal Service's revenue requirement in this docket as out of touch with reality. He urges the Commission to "prompt disclosure, on the record, of the Postal Service's rapidly improving financial health and of the Service's prospect—even under current rates—for continued robust surpluses."[1] My testimony rebuts Dr. Stapert's assertions by demonstrating the reasonableness of the Postal Service's revenue requirement, and explaining why changing the revenue requirement in this case, other than to reflect actual FY 1997 results in the recovery of prior years' losses calculation, is neither appropriate nor necessary. I also provide a summary of test year revenue requirement changes that result from the use of actual inflation data and other known significant test year changes.

II. FLAWS IN DR. STAPERT'S VIEWS

Dr. Stapert states that as a practicing clinical psychologist he meets people "whose perception of reality is significantly distorted"[2] and that "the Postal Service's revenue requirement reminds me of such patients."[3] He bases his diagnosis on the fact that the Postal Service has restored a significant amount of its negative

[1] CRPA-T-1, page 10, line 23.
[2] CRPA-T-1, page 10 line 3.
[3] CRPA-T-1, page 10, line 8.

equity over the past three years and the fact that it did better financially in FY 1997 than *the net income reflected in its operating budget.*

Dr. Stapert asserts that because the Postal Service did better financially in FY 1997 than was estimated in its operating budget, the test year revenue requirement is no longer reasonable. Just as a doctor would not diagnose a patient's condition merely on the basis of one symptom, ignoring the patient's other conditions and medical history, neither can the financial condition of the Postal Service be assessed so superficially. Further examination reveals that Dr. Stapert's views suffer from serious flaws.

First, Dr. Stapert has done no analysis to ascertain what factors contributed to better-than-estimated performance in FY 1997 or if the differences between actual results and the rate case estimates carry forward into the test year. He has ignored evidence showing that several significant variances which contributed to the favorable financial outcome in FY 1997 will not recur in the test year.[4] I discuss these more fully below.

Second, Dr. Stapert has also not addressed other critical factors affecting the Postal Service's financial condition that were raised by witness Tayman in his testimony. "Without the proposed rate increase, the Postal Service cannot meet the Board of Governors' policy on equity restoration, nor can it fund expenditures critical to

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[4] Tr. 9/4437-40.

the future viability of the Postal Service." USPS-T-9, at 9. Dr. Stapert also does not take into account Mr. Tayman's explanation that, because of the hypothetical nature of the test year, the proposed rates and additional net revenue were intended to and will endure beyond the test year in this case. Tr. 9/4458. The net revenue generated by the requested rate increases is intended to fund, among other things, programs "designed to continue service improvements, improve responsiveness to customers, maintain and improve our infrastructure, and reduce costs in the future." *Id.* Any proposal which could result in a substantial reduction in the net revenue requested by the Postal Service must address the issue of how the Postal Service can carry out programs and policy choices determined by management and the Board to be in the best interests of the Postal Service and the public without the rates and revenue requested. Dr. Stapert's overly simplistic analysis has failed to address these issues, which I also discuss in more detail below.

Finally, in his testimony Dr. Stapert refers to the variance between rate case estimates and the FY 97 operating budget as a basis for criticizing the Postal Service's revenue requirement. Tr. 22/11745. He does not take account of the fact that the operating budget was developed prior to the FY 1997 estimate developed for the rate case and reflected significantly less net income ($55 million in the Operating Budget versus $636 million in the rate case). Dr. Stapert has reconsidered his position, stating in response to an interrogatory that "within the context of this proceeding, variances from the rate-case estimate of $636 million FY 97 net income are more relevant than are variances from the Postal Service's FY 97 plan of $55 million net income." Tr. 22/11765.

III. THE POSTAL SERVICE'S REVENUE REQUIREMENT AND MANAGEMENT'S GOALS AND OBJECTIVES.

It is essential that the Commission's Recommended Decision not undermine the goals and objectives set by postal management. Management's financial goals and objectives are established as part of an extensive process. These goals, and the future of the Postal Service, could be compromised by significant changes to the amount of net revenue requested by the Postal Service. In this respect, I endorse and adopt the response that witness Tayman provided to DMA/USPS-T9-39, which was apparently not included in the record thus far. As witness Tayman, explained, and as I also believe:

> If changes to the revenue requirement were to result in a Recommended Decision that significantly changed the amount of net revenue requested by the Postal Service in this filing, management's current goals and objectives could be undermined, especially if the revisions were to result in significant departure from the Postal Service's proposals. As I have tried to explain, management's assessment of the overall revenue requirement is the result of balancing a complex array of quantitative and subjective considerations. The entire filing, furthermore, including the specific pricing and classification proposals, embodies management's judgment about how those considerations should be balanced, and about the appropriate financial policy goals for the Postal Service. This is not to say that any departure from specific proposals or

estimates would necessarily compromise management's financial policy. I do believe, however, that any mechanical adjustment of the revenue goals in the case due to more recent information, in a way that would lead to substantial change in the Postal Service's pricing and other proposals, would be a mistake and would likely subvert the Postal Service's policy objectives. Accordingly, any changes in estimates due to actual performance or other events should be assessed comprehensively, and not selectively, and should be evaluated in the context of the entire filing. In this respect, it would not be unreasonable, nor unprecedented, for the Postal Service to conclude that the effects of particular changes, including actual financial performance, caused a reassessment of the elements of the revenue requirement in a way that permitted the Postal Service to determine that its financial and other policy objectives were still best served by adherence to its original revenue requirement. In fact, this is exactly the reasoning that has led the Postal Service to conclude in past cases that unforeseen expenses or liabilities that came to light during the litigation did not alter its proposals. For example, this is what happened in Docket No. R90-1, with the passage of the Omnibus Budget Reconciliation Act (OBRA) of 1990. In that case, the Postal Service evaluated the effects of the change and decided that the increased expenses in the interim and test years should not alter the overall amount of revenue sought in the case. Rather, the Postal Service would settle for a reduction in the amount available for contingencies, which in the context of the entire filing was judged to be a reasonable adjustment. A similar reassessment might be appropriate on the particular facts of this case.

Reducing the revenue requirement would undermine the Board's financial policy with respect to program initiatives, the size and frequency of rate increases, and the restoration of equity. I agree completely with Mr. Tayman's assessment and urge the Commission to evaluate the impact of any potential revenue requirement changes so as not to subvert the policy objectives of management and the Board, should it decide to update the Postal Service's original estimates despite the compelling reasons not to update, which I now present.

IV. THE PITFALLS OF CHANGING ORIGINAL ESTIMATES

A. Conceptual Flaws and the Issue of Fairness

Due to the time it takes to develop and litigate a rate case, it is inevitable that some of the factors upon which the original estimates were based will change subsequent to the filing, and this case is no exception. However, when looked at comprehensively, the revenue requirement requested by the Postal Service in this case remains a reasonable basis upon which to base new rates and the Postal Service believes that no adjustments are necessary.

The practice of substituting updated information for original estimates complicates the ratemaking process. I believe such an approach is unwise for a number of reasons. Updated information does not receive the thorough analysis and review by interested parties that the ratemaking process provides for original estimates. It seems unfair for intervenors to spend months evaluating the Postal Service's estimates only to have them changed after the fact. A Recommended Decision based on information substituted for original estimates at the end of the case does not afford rate case participants the opportunity to review, analyze and comment on the ramifications of the changes. Without a complete update of all affected testimonies, workpapers, and a re-running of the rollforward model (i.e. starting over again from scratch), updating also increases the odds of errors and a flawed revenue requirement. When major changes are made to the original filing, issues that might otherwise have been resolved during the process of discovery and hearings would not even surface until after the Commission's Recommended Decision is a fait accompli.

B. FY 1997 Actual Results

Before I discuss other potential problems that could result from updating, I will address FY 1997 actual results and their potential effect on Test Year expense estimates. (See Exhibit A). It must first be noted that most of the favorable variance to FY 1997 estimated net income was related to revenue, which was higher than estimated, primarily because of the UPS strike. Actual FY 1997 expenses were only 0.3 percent under the amount estimated in the filing. This relatively minor difference is a strong indication that the substitution of actual FY 1997 expenses for the FY 1997 estimates reflected in this filing would add needless complexity to the case and is unnecessary. Because the FY 1997 expense estimates were very close to the actual results, the adjustment of FY 1997 estimates to reflect actual FY 1997 expenses into the rollforward model should not have a significant effect on test year segment costs. In addition, the substitution of actual FY 1997 expenses for the amounts currently reflected in the filing carries the significant risk, which I will discuss below, that invalid or insufficient test year estimates could result.

C. Technical Problems

Technical problems could also result from the substitution of actual FY 1997 results as the base from which expenses are rolled-forward into the test year. The UPS strike had a dramatic effect on FY 1997 finances. While approximations of how much revenue and expense related to the strike should or should not be rolled-forward into the test year might be made, the accuracy and validity of such estimates would be questionable. I believe reliance on the FY 1996 actual base provides a representative and valid test year revenue requirement.[5]

Another technical issue relates to the fact most of the other program change factors used to develop test year cost component estimates reflected in the rollforward were zero based. Even though some programs incurred less expense than estimated for FY 1997, this does not reduce the amount required for other programs in the test year. If the Commission were to update FY 1997 to reflect actual expenses, the

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[5] Any effects on FY 1996 operational experience arising from changes due to classification reform have been considered in the rollforward model and addressed elsewhere in the record of these proceedings. These adjustments are discussed in the testimony of witness Patelunas, USPS-T-15, pages 14-15. The calculation of the adjustments is presented in USPS LR-H-126.

application of the original other program change factors would in many cases result in underestimated cost component totals for the test year and would have a detrimental impact on the future life of the programs. For example, the cost of component 174, ADP supplies and services, was estimated to be approximately $426 million for FY 1997 and $721 million in the test year due to a major emphasis on new and upgraded computer systems including Point of Service, Corporate Call Management, Associate Office Infrastructure, Air Reservation System, and Year 2000 Software. The actual FY 1997 expenses for component 174 were less than estimated. Thus the addition of the original test year other program change factor of $295 million to actual FY 1997 component 174 costs would result in a test year estimate that is insufficient to support the Postal Service's program plans during the test year and in future years during which the proposed rates might be in effect. This effect would apply to other programs as well. As witness Tayman testified, these initiatives are "designed to continue service improvements, improve responsiveness to customers, maintain and improve our infrastructure, and reduce costs in the future." USPS-T-9, at 9. They are critical elements in carrying out the Board of Governors' policy determinations.

Another similar example of this situation relates to workers' compensation expense. As witness Tayman testified, the reduction to FY 97 workers' compensation expense relates mainly to prior year injury costs and is not expected to be repeated in the test year. Tr. 9/4439. Consequently, the addition of the original workers' compensation other program change factor for the test year to the actual expense for FY 1997 would result in a total test year expense that is too low.

As the discussion above makes clear, virtually all change factors for other programs would require recalculation in order to present accurate Test Year estimates if FY 1997 actual results are substituted for the current FY 1997 estimates. While this could be done, it would be time consuming and would not be superior to relying on the original estimates, in light of the overall appropriateness of the Postal Service's proposals.

A related technical issue which warrants examination is the complexity and difficulty of substituting FY 1997 actual results into the Rollforward Expense Factor Model(s) contained in Library Reference H-12. Incorporating these changes would involve not only the development and incorporation of updated actual data, but would also require changes to the models themselves in order to accommodate FY 1997 as the base year. Such changes would require a significant amount of re-programming and manual intervention, including revisions of numerous supporting schedules and workpapers. The time required to identify and calculate the required adjustments, substitute the results into the rollforward factor development model, make any needed adjustments to other model components, and produce updated rollforward factors would be substantial. The need to update for actual data could also be construed to apply to actual FY 1997 mail volume. Such an exercise would for all practical purposes result in completely redoing the revenue requirement. In my opinion, it is both unwise and unwarranted to attempt such major revisions at the eleventh hour. This is particularly true when the factors produced by such an exercise and their use in developing updated test year costs are untested and would not be subjected to scrutiny as part of this proceeding. When one considers the relatively minor differences between the expenses estimated for FY 1997 and actual FY 1997 expenses, and the relatively minor effect on test year expenses of the changes which are identified in Exhibits B and C, it becomes intuitively obvious that updating should have a negligible impact on the overall test year revenue requirement if calculated correctly and properly applied. However, updated factors and changes could result in errors and a deficient revenue requirement if calculated incorrectly or improperly applied. In the final analysis, updating for FY 1997 actual results would not be superior to relying on estimates founded on the original FY 1996 base year.

D. Impact of Other Changes on the Revenue Requirement

In addition to FY 1997 actual results, a number of other changes have occurred that affect test year accrued costs. In total, these changes have a relatively minor impact and for that reason I would argue that there is no compelling reason to make the adjustments, particularly when the numerous problems associated with updating are considered. The identified changes to test year accrued cost are calculated in my workpapers and exhibits and summarized in Exhibit B. The revenue requirement is summarized in Exhibit C. I will briefly discuss each of the changes that have been identified.

The July 1997 and January 1998 cost-of-living allowances (COLA) paid to bargaining unit employees beginning August 30, 1997 and March 14, 1998 were estimated to be $333 and $270 per eligible employee, based on the DRI forecast for the CPI-W used for this filing. The actual COLAs were lower than estimated at $166 and $167 per eligible employee. This reduces the test year personnel cost level change by $207.8 million, CSRS Unfunded Liability expense by $17.8 million, and repricing of annual leave expense by $3.2 million.

The employer contribution rate for employees covered by the Federal Employees' Retirement System (FERS) was reduced from 11.4 percent to 10.7 percent of basic pay, effective October 1, 1997. This change was not known at the time the revenue requirement was developed and reduces the test year personnel cost level change by $102.3 million.

The effect of actual Federal Employee Health Benefit Program premiums has also been calculated. The Office of Personnel Management had estimated that the employer share of health benefit premiums effective on January 3, 1998 would increase by an average 5.0 percent, and this assumption was used to develop personnel cost level factors and annuitant health benefit costs in this filing. The actual change in average Postal Service annuitant health benefit premiums was 4.6 percent. This amount was calculated from the December, 1997 and January, 1998 annuitant health benefit bills from the Office of Personnel Management. The actual increase in average premiums per active employee was 3.72 percent based on the USPS health benefits enrollment status report, which reflects the actual cost of premiums and the number of covered employees both before and after the open season. These changes decrease test year personnel costs by $23.0 million.

In addition to cost level, the personnel cost changes discussed above also impact personnel related cost reductions, other programs, workload, and the workyear mix adjustment. The net test year impact of these changes is a decrease of $3.6 million.

The test year effect of actual FY 1997 inflation indices on non-personnel costs and CSRS annuitant COLAs has also been calculated. CSRS annuitant COLA costs are reduced by $27.2 million when actual calendar year third quarter CPI indices are substituted for the estimated third quarter indices. Test year transportation costs are reduced by $57.6 million as a result of substituting actual FY 1997 inflation indices for the DRI inflation estimates used in the filing and the net impact of similar changes on all other non-personnel costs is an increase of $0.7 million. The non-personnel cost level changes are quantified in Exhibit G.

Note interest will be lower in the test year by $116.3 million as a result of borrowing less than estimated at the end of FY 1997. Test year note interest was updated to reflect this change. Tr. 19C/9199-9204. This decrease is partially offset by the capitalization of less interest expense than originally estimated in this filing. The original capitalized interest estimate of $67.4 million has been reduced by $29.4 million to reflect FY 1997 actual results. Projects are being closed out in a more timely manner than originally assumed and a significant amount of building improvement projects are under $5 million (interest on which is not subject to capitalization).

The Postal Service assumed the liability for Post Office Department Workers' Compensation costs as required by recently-enacted budget reconciliation legislation (P.L. 105-33). This increases test year costs by $14.3 million as calculated in the response to OCA/USPS-T10-1, which I have included in my workpapers.

The Postal Service has also been required to comply with Financial Accounting Standards Board Statement (FASB) 121 which relates to the treatment of impaired assets. FASB 121 requires that impaired buildings be revalued to the lower of the building's fair market value or undepreciated balance. This resulted in $56.8 million of additional depreciation expense in FY 1997 and is estimated to increase test year depreciation expense by $15.0 million.

I have also included a reduction of $55.3 million to reflect a correction to the calculation of the FY 1997 volume variability adjustment calculated by witness Patelunas. The corrected amounts were calculated in the response to Presiding Officer's Information Request No. 12, question 7.

There are also several significant changes to programs. Program cost changes are summarized in Exhibit E.

Through accounting period five of FY 1998, highway transportation costs are 11.6 percent higher than the same period in FY 1997. This trend is expected to continue through the end of FY 1998. More stringent two- and three-day service goals and an increased emphasis on achieving those goals has resulted in additional highway transportation costs. As reflected in Exhibit F, highway transportation costs are estimated to add an additional $115.8 million to test year costs.

The establishment of most of the new Mail Transportation Equipment Centers has been deferred until FY 1999. The program manager has indicated that most of these costs will not be incurred in FY 1998. This reduces test year costs by a net of $52.2 million.

The Year 2000 Software program has been better defined since the rate case estimates were made and it was determined that a more aggressive posture is necessary in order to ensure that the Postal Service's systems are upgraded to deal with year 2000 issues. This increases test year costs by $298.0 million and represents a critically important need for the future.

While some other programs are currently behind on their spending plans, their program managers have indicated that they will catch up as the year progresses. They have indicated that approved FY 1998 program expenses will be incurred. The rate increase requested by the Postal Service is intended to fund investments in equipment, facilities, and systems necessary to hold down costs and continue to improve service quality. These programs and the revenue requirement level necessary to support them have been carefully reviewed and approved by management and the Board of Governors. There is no justification for any reduction of these planned expenses from the levels included in the revenue requirement. In my opinion, any adjustment of these estimates in the nature of predicting expenses based on actual experience for FY 1997 or the first part of FY 1998, would constitute inappropriate interference with the execution of the Board's policy in choosing to fund these programs.

The effect of all of the changes discussed above is summarized on Exhibit B. These changes result in a net decrease to test year expenses of $195.0 million or 0.3 percent of the original amount estimated for test year accrued costs. In my opinion changes of this magnitude do not warrant updating the Postal Service's revenue requirement for reasons on which I elaborate below.

V. GIVEN ALL RELEVANT FACTS, THE REVENUE REQUIREMENT SHOULD NOT BE ADJUSTED

A. Balancing Conflicting Goals

The Postal Service opted to assume additional risk by requesting the smallest percentage contingency provision ever in this filing because of an overriding desire to keep rate increases as low as possible and below the rate of inflation. Faced with balancing the conflicting goals of providing adequate protection against unforeseen events during the test year and beyond, and keeping rate increases below the rate of inflation, the Postal Service chose to emphasize the latter in this case. The Postal

Service opted to live with a level of protection below what it normally would have considered adequate in order to accommodate its rate level goals. As witness Tayman testified, "the Postal Service might have opted for a larger contingency if the test year costs projected for this filing had been lower." Tr. 9/4458. Let me reinforce Mr. Tayman's testimony by stating that had the moderately lower expenses I have documented in my testimony been known, I would have recommended a slightly larger contingency to the Board.

While improved financial results may have diminished the amount of risk associated with such a small contingency provision, the rates requested by the Postal Service in this filing remain reasonable. They represent an overall increase that is less than half the rate of general inflation; and by waiting until the fourth quarter of FY 1998 or later, their implementation will have been deferred for at least a year and a half longer than was originally anticipated. The goals of extending the rate cycle and keeping the rate increase below the rate of inflation are being accomplished without jeopardizing the progress that has been made in recovering prior years' losses.

B. Other Considerations

Another factor that contributed to the original decision to opt for a lower contingency provision was the favorable economic environment that existed at the time the rate case was developed. Although the Postal Service's recent financial results have been favorable, the economic outlook is currently considerably more uncertain due to the recent Asian and Latin American financial crises.

I am also aware of draft Congressional legislation which would require the Postal Service and other Federal agencies to absorb the cost of correcting financial inequities suffered by employees who were placed in the wrong retirement plan during the period 1984 to 1987 when the Government established the Federal Employees Retirement System. Rough preliminary estimates indicate that the Postal Service could incur significant unanticipated costs during the test year.

Were the rate case filing being made at this time, the increased potential for adverse economic and legislative impacts during the test year would clearly support the need for more protection during the test year in the form of a larger contingency provision. For example, an amount equaling 1.5 percent of accrued expenses would still be less than the 2.0 percent requested in Docket No. R94-1 and the 3.5 percent contingencies requested in the three rate cases prior to that.

The Postal Service remains satisfied with its filing based on its original estimates and its requested revenue requirement and does not believe changes are necessary or warranted. Recommending the revenue requirement requested by the Postal Service could be viewed as the recognition of moderately lower expense levels that are offset by a slightly larger contingency. However, should the Commission be inclined to make significant changes or attempt to update the Postal Service's revenue requirement, it should consider the practice followed in prior cases where it refrained from explicitly incorporating evidence of increased costs based on actual experience. The resulting revenue requirement effectively provided less for contingencies than originally requested. In this case, the revenue requirement requested by the Postal Service to carry out Board policies leaves more for contingencies if the Commission reduces estimates based on actual experience. The resulting effective contingency in the range of 1.5% would be very reasonable.

C. Lessons from Docket No. R90-1

The Commission should be mindful of the adverse consequences that resulted from changes to the Docket No. R90-1 revenue requirement. In that case the Postal Service took the position that its revenue requirement remained at an appropriate level *despite changes that had taken place after the filing. These changes included the* additional test year costs related to the OBRA of 1990 which only became known very late in the proceeding. At the time the impact of OBRA became known, the Postal Service advised the Commission that the additional OBRA costs would have a large negative effect on the Postal Service's financial condition and would effectively reduce the Postal Service's contingency provision from the 3.5 percent it had requested to 2.3 percent. Recognizing the practical constraints involved in dealing with updated information, especially after the record had closed, the Postal Service made a decision to live with the rates and revenue requirement it had requested even though they were now considered to be deficient as a result of the OBRA of 1990. Instead of accepting the Postal Service's compromise position, the Commission opted to adjust the Postal Service's revenue requirement in such a way as to include the costs of the OBRA of 1990 and still balance back to a revenue requirement that was close to the amount originally requested. According to the Commission, the revenue requirement they recommended *"differs from that proposed (and adhered to in the face of subsequent* developments) by the Postal Service, but since it rests on recognition of established facts we consider it a more soundly-based revenue requirement figure."[6] The Commission also reduced the rate increases requested by the Postal Service and then claimed, based on its view of updated information, that their revised rates would produce the same amount of revenue estimated by the Postal Service to result from the rates it requested. The Commission estimated that the net impact of its changes to rates and the revenue requirement would produce a test year net income very close the amount estimated by the Postal Service in its filing.

If the Commission's changes had been valid, the Postal Service would have realized a net income during the test year (FY 1992). Instead the Postal Service incurred a sizable net loss. While part of the contingency provision had to be used to offset the cost of restructuring, even with that un-anticipated cost the Postal Service should have been able to realize a net income if the Commission's estimates had been reliable. Exhibit D compares the Commission's Docket No. R90-1 Recommended

[6] Docket No. R90-1, Postal Rate Commission Opinion and Recommended Decision, Volume 1, Page II-1 (January 4, 1991).

Decision to actual FY 1992 results. The Commission's updated revenue estimate was $885 million more than the revenue that actually resulted from the reduced rates it recommended. The Commission's accrued cost estimate was $743 million lower than actual Postal Service expenses. The Commission's changes clearly did not result in estimates that were closer to actual results than would have resulted if the Postal Service's filing had been left unchanged as the Postal Service had urged. The Commission's changes and mis-estimates resulted in a combined revenue shortfall and cost overrun of $1.628 billion which effectively consumed the entire 3.5 percent contingency provision recommended by the Commission. The amount requested for contingencies in this case is much smaller and would therefore not be able to compensate for mis-estimates of the same magnitude experienced in the Docket No. R90-1 test year.

VI. CONCLUSION

For all these reasons, I believe that the revenue requirement underlying the current filing remains reasonable and does not require any adjustment. On behalf of the Postal Service, I urge the Commission not to repeat the mistake it made in Docket No. R90-1 when it substantially changed the Postal Service's revenue requirement. These changes seriously compromised management's financial goals and objectives and contributed to the occurrence of a loss in the test year. My testimony has clearly demonstrated that the revenue requirement requested by the Postal Service remains a reasonable basis for determining new rates, and the amount of revenue required to support the goals and objectives established by Postal Service management and the Board of Governors. I encourage the Commission to render a Recommended Decision that is supportive of, and consistent with, these initiatives.

EXHIBITS

EXHIBIT
USPS-RT-11A

STATEMENTS OF REVENUE AND EXPENSE
($ IN MILLIONS)

COST SEGMENT		FY 1997 ESTIMATE	FY 1997 ACTUAL	Over (Under) Estimate Amount	%
	REVENUES				
	OPERATING REVENUE	57,707.7	58,132.0	424.4	0.74%
	APPROPRIATIONS	83.4	83.4	0.0	0.00%
	INTEREST INCOME	100.2	115.3	15.1	15.08%
	TOTAL REVENUES	**57,891.3**	**58,330.8**	**439.5**	**0.76%**
	EXPENSES				
1	POSTMASTERS	1,668.9	1,707.2	38.3	2.29%
2	MANAGERS, SUPERVISORS & TECHNICAL PERSONNEL	3,355.5	3,387.2	31.7	0.94%
3	CLERKS & MAILHANDERS	17,062.7	17,287.7	225.0	1.32%
4	CLERKS, CAG K POST OFFICES	9.7	9.1	(0.6)	-6.45%
6&7	CITY DELIVERY CARRIERS	11,816.3	11,818.5	2.1	0.02%
8	VEHICLE SERVICE DRIVERS	433.5	441.2	7.8	1.79%
9	SPECIAL DELIVERY MESSENGERS	109.7	103.3	(6.4)	-5.80%
10	RURAL CARRIERS	3,575.8	3,528.3	(47.6)	-1.33%
11	CUSTODIAL & MAINTENANCE SERVICES	2,188.9	2,220.5	31.6	1.44%
12	MOTOR VEHICLE SERVICES	619.3	651.1	31.8	5.14%
13	MISCELLANEOUS LOCAL OPERATIONS	279.1	292.5	13.5	4.83%
14	CONTRACTURAL TRANSPORTATION OF MAIL	4,112.7	4,053.1	(59.6)	-1.45%
15	BUILDING OCCUPANCY	1,412.2	1,328.0	(84.3)	-5.97%
16	SUPPLIES & SERVICES	2,707.1	2,368.6	(338.4)	-12.50%
17	RESEARCH & DEVELOPMENT	54.2	68.4	14.2	26.13%
18	HQ & AREA ADMIN. & CORPORATEWIDE PERSONNEL COSTS	4,166.3	3,999.7	(166.6)	-4.00%
19	EQUIPMENT MAINT. & MANAGEMENT TRAINING SUPPORT	36.4	29.1	(7.3)	-19.93%
20	DEPRECIATION, WRITE-OFFS, CLAIMS, & INTEREST	3,647.3	3,772.7	125.4	3.44%
	TOTAL ACCRUED COSTS	**57,255.7**	**57,066.4**	**(189.4)**	-0.33%
	NET INCOME (LOSS)	635.6	1,264.4		

EXHIBIT
USPS-RT-11B

Impact of Known Changes on Docket R97-1 Test Year Accrued Costs
($000)

Description	Cost Segment	Component	COLAs 1/	Oct. 1, 1997 FERS Cont. Rate Chg. 2/	Jan. 3, 1998 Health Ben. Prem. Chg. 3/	Actual Inflation Indexes	Other	Totals 10/
Employee Personnel Cost Level (FY 97)	Various	Various	(12,396)					(12,396)
Employee Personnel Cost Level (FY 98)	Various	Various	(195,400)	(102,348)	(23,059)			(320,807)
CSRS Unfunded Liability Principal	18	203	(9,615)					(9,615)
CSRS Unfunded Liability Interest	20	1436	(8,251)					(8,251)
CSRS Annuitant COLA Principal 4/	18	1435				(27,159)		(27,159)
Annuitant Health Benefits	18	208			(1,749)			(1,749)
Repricing of Annual Leave	18	199	(3,218)					(3,218)
Personnel Related Cost Reductions (FY 97) 5/	Various	Various					281	281
Personnel Related Cost Reductions (FY 98) 5/	Various	Various					7,430	7,430
Personnel Related Other Programs (FY 97) 5/	Various	Various					(131)	(131)
Personnel Related Other Programs (FY 98) 5/	Various	Various					(3,911)	(3,911)
Workload 5/	Various	Various					(6,365)	(6,365)
Mix Adjustment 5/	3,6,7	253,256,257					(874)	(874)
POD Workers' Compensatation 9/	18	205					14,330	14,330
Note Interest (actual borrowing) 6/	20	587					(116,320)	(116,320)
Capitalized Interest 7/	20	587					29,400	29,400
Transportation 11/	14	Various				(57,560)		(57,560)
All Other Non-Personnel 11/	Various	Various				654		654
Other Programs 12/	Various	Various					361,609	361,609
FY 97 Volume Variability Adjustment 13/	3,11	253,75					(55,298)	(55,298)
Building Depreciation (FASB 121) 8/	20	236					15,000	15,000
Totals			(228,880)	(102,348)	(24,808)	(84,065)	245,151	(194,950)

Notes:

1- August 30, 1997 COLA estimated at $333 vs. actual of $166. March 14, 1998 COLA estimated at $270 vs. $167 actual. See my workpapers.

2- FERS Contribution rate decreases from 11.4% to 10.7% on 10/1/97. See my workpapers.

3- Employer share of health benefit premiums to increase 3.72% for employees and 4.6% for annuitants versus estimate of 5.0%. See my workpapers.

4- CSRS annuitant cola revised to reflect actual PQ IV 1997 actual CPI-W. See my workpapers.

5- Cost reductions, other programs, workload (mail volume, non-volume workload and additional workday) and mix adjustment recalculated to reflect updated cost level factors due to revised cola, health benefit premiums and FERS conribution rate. See my workpapers.

6- Note interest adjusted to reflect impact of actual borrowing in FY 1997. See OCA/USPS-106 and LR H-12 VIb.

7- Interest capitalized revised to reflect actual experience in estimation methodology. See my workpapers.

8- Building depreciation revised to reflect anticipated write off of impaired assets (FASB 121). Judgementally determined by technical staff.

9- FY 98 POD workers' compensation cost reflects liability transfer to USPS under Public Law 105-33. See OCA/USPS-T10-1.

10- These amounts adjust the test year after rates expenses contained in the Docket R97-1 filing.
FY 97 impacts of these changes which carryover into the test year have also been estimated.

11- Substitution of actual FY 97 inflation indexes for DRI forecast used in rate filing. See Exhibit USPS-RT-11G.

12- Net impact of deferred/accelerated programs. See Exhibit USPS RT-11E.

13- Corrrection of error in USPS-T-15 Appendix A. See response to POIR 12.7.

EXHIBIT
USPS-RT-11C

Impact of Updating on Docket R97-1 Test Year Revenue Requirement
Dollars in Millions

	Original Filing 1/	Updates	Revised Test Year
Total Revenue	61,651.8		61,651.8
Total Accrued Costs	60,563.6	(195.0)	60,368.7
Contingency	605.6	299.9	905.5
Expenses With Contingency	61,169.3	104.9	61,274.2
Prior Years' Loss Recovery	446.9	(69.9)	377.1
Total Revenue Requirement	61,616.2	35.1	61,651.3
Net Surplus (Deficiency)	35.6	(35.1)	0.6

Prior Years' Loss Recovery Calculation	Original Filing 2/	Updates	Revised Test Year
Deficit from Operations FY 72 - FY 96	5,658.0		5,658.0
FY 97 Net Income	635.6	628.8	1,264.4
Less: Funds from PL No. 94-421	1,000.0		1,000.0
Amount of Recovery Required	4,022.4	(628.8)	3,393.6
Annual Increment @ 1/9	446.9	-69.9	377.1

1/ USPS-9A
2/ Table 53, USPS-T-9

EXHIBIT
USPS-RT-11E

Major Program Changes Impacting Docket R97-1 Test Year
Dollars in Thousands

		Deferred		Accelerated/New				
Segment	Component	Mail Transportation Equipment Centers		Year 2000 Software		Highway Service Improvement		Totals
14	143	(9,981)	1/			115,763	5/	105,782
15	165	(3,368)	1/					(3,368)
16	175/177	(133,685)	1/					(133,685)
16	184	20,000	4/					20,000
								-
16	174			298,000	3/			298,000
Costs		(127,034)		298,000		115,763		286,729
3	253	41,431	2/					41,431
11	75	7,922	2/					7,922
16	184	24,285	2/					24,285
14	143	1,241	2/					1,241
Savings		74,879				-		74,879
Total changes		(52,154)		298,000		115,763		361,609

1/ Library Reference H-10 Exhibit B (81% of non-personnel costs estimated to slip by program manager).
2/ Library Reference H-10 Exhibit C (96% of non personnel cost savings and 100% of personnel cost savings estimated to slip by program manager).
3/ Additional ADP contractual services required to accelerate Year 2000 Software Program. Estimate developed by program managers.
4/ Additional mail transportation equipment required due to delay in opening of Mail Transportation Equipment Support Centers. Estimate developed by program managers.
5/ Highway transportation service initiatives. See Exhibit F.

EXHIBIT
USPS-RT-11G

IMPACT OF FY 1997 ACTUAL NON-PERSONNEL INFLATION FACTORS ON R97-1
($ 000)

Seg	Comp	Name	Inflation Driver	R97-1 FY 97 Est Inflation	R97-1 FY 96 Base Amt	R97-1 FY 97 Calc Cost Lvl \1	R97-1 FY 97 Calc WL, NV, ADD \1	R97-1 Total Increase w/ Est. Infl	FY 97 Actual Inflation	R97-1 FY 97 Calc Increase w/ Actual Infl	FY 97 Incrase/ (Decrease)	R97-1 FY 98 Est Inflation	R97-1 FY 98 Calc Cost Lvl Impact
10	73	Rural Carrier EMA	Anal of EMA Change	4.4291%	302,628	13,404	6,814	20,218	4.2406%	19,635	(583)	2.1357%	(12)
11	81	Contract Cleaners	Rents	2.9700%	49,765	1,478	(495)	983	2.8400%	919	(64)	3.1900%	(2)
12	99	Vehicle Supplies & Materials	Supplies & Materials	0.6200%	303,058	1,865	2,454	4,319	0.1500%	2,897	(1,422)	0.1900%	(3)
	108	Rental of Motor Vehicles	Transportation Services	3.3700%	26,831	906	424	1,330	3.0900%	1,252	(78)	2.8800%	(2)
13	115	Individual Awards	CPI	2.9100%	38,306	1,115		1,115	2.5900%	992	(123)	2.6100%	(3)
	111	Contracts Stations	Rents	2.9700%	67,986	2,019	2,417	4,436	2.8400%	4,345	(91)	3.1900%	(3)
	112	Rental Allowance-Postmasters	Rents	2.9700%	48	1	(2)	(1)	2.8400%	(1)	0	3.1900%	0
	113	Tolls & Ferriage	Public Transportation	5.5800%	3,631	203		203	4.6100%	167	(36)	4.4200%	(2)
	117	Freight-Supplies & Materials	Transportation Services	3.3700%	1,511	509	(7)	502	3.0900%	41	(461)	2.8800%	(13)
	125	Banking Fees	CPI	2.9100%	31,126	906		906	2.5900%	806	(100)	2.6100%	(3)
	135	Carfare	Public Transportation	5.5800%	46,704	2,599	117	2,716	4.6100%	2,269	(447)	4.4200%	(20)
	141	City Carrier Driveout	Public Transportation	5.5800%	5,259	290	114	404	4.6100%	355	(49)	4.4200%	(2)
14	142	Domestic Air	Air Transportation	6.6300%	1,253,695	83,119	66,896	150,015	3.6200%	110,391	(39,624)	-2.9400%	1,165
	143	Domestic Highway	Highway Transportation	3.5100%	1,541,650	54,113	61,233	115,346	2.8800%	105,260	(10,086)	1.4000%	(141)
	144	Domestic Rail	Rail Transportation	1.1900%	250,228	2,978	10,939	13,917	0.2800%	11,541	(2,376)	2.8600%	(68)
	145	Domestic Water	Transportation Services	3.3700%	24,119	811	1,237	2,048	3.0900%	1,979	(69)	2.8800%	(2)
	146	International	Weighted Air/Water	2.3568%	666,121	15,699	(58,500)	(42,801)	1.3024%	(49,222)	(6,421)	-0.9726%	62
15	500	Rents	Rents	2.9700%	570,106	16,932	31,729	48,661	2.8400%	47,880	(781)	3.1900%	(25)
	166	Heating Fuel	Weighted Oil/Gas	10.6281%	51,307	5,453	(548)	4,905	7.8800%	3,509	(1,396)	0.1438%	(2)
	167	Utilities	Electricity	0.1300%	362,243	471	(3,503)	(3,032)	0.7700%	(736)	2,296	0.1600%	4
	168	Communications	WPI for Industrial Commod	1.1900%	136,289	1,622	(59)	1,563	0.7000%	895	(668)	0.2400%	(2)
	169	Building Projects Expense	WPI for Industrial Commod	1.1900%	175,214	2,085		2,085	0.7000%	1,226	(859)	0.2400%	(2)
	170	Moving Expense	Transportation Services	3.3700%	4,482	151		151	3.0900%	138	(13)	2.8800%	(0)
	171	Reimbursements	WPI for Industrial Commod	1.1900%	24			-	0.7000%	0	0	0.2400%	0
16	174	ADP Supplies & Services	Supplies & Materials	0.6200%	202,995	1,259		1,259	0.1500%	304	(955)	0.1900%	(2)
	175	Equip Repair & Maint Exc ADP	Supplies & Materials	0.6200%	31,108	193		193	0.1500%	47	(146)	0.1900%	(0)
	176	Custodial Supplies & Services	Supplies & Materials	0.6200%	129,486	803		803	0.1500%	194	(609)	0.1900%	(1)
	177	Misc Supplies & Services	Supplies & Materials	0.6200%	900,929	5,586		5,586	0.1500%	1,351	(4,235)	0.1900%	(8)
	179	Printing & Reproduction	Printing Services	-5.8200%	46,350	(2,698)		(2,698)	-0.0691%	(32)	2,666	2.8800%	77
	180	Stamps & Acct Paper	Printing Services	-5.8200%	191,201	(11,129)	1,060	(10,069)	-0.0691%	993	11,062	2.8800%	319
	181	Money Orders	Printing Services	-5.8200%	3,996	(233)	73	(160)	-0.0691%	75	235	2.8800%	7
	184	Operating Equip & Supplies	Supplies & Materials	0.6200%	474,052	2,938	6,341	9,279	0.1500%	7,022	(2,257)	0.1900%	(4)
	189	Reimbursements	Supplies & Materials	0.6200%	(5,546)	(34)		(34)	0.1500%	(8)	26	0.1900%	0
	248	Stamped Envelopes	Printing Services	-5.8200%	12,208	(711)	(1,170)	(1,881)	-0.0691%	(1,250)	631	2.8800%	18
18	1429	Individual Awards	CPI	2.9100%	2,790	81		81	2.5900%	72	(9)	2.6100%	(0)
	210	Supplies & Services	Supplies & Materials	0.6200%	155,309	963		963	0.1500%	233	(730)	0.1900%	(1)
	212	Inspection Svc Expense	CPI	2.9100%	2,594	75		75	2.5900%	67	(8)	2.6100%	(0)
	213	Reimbursements	CPI	2.9100%	(4,303)	(125)		(125)	2.5900%	(111)	14	2.6100%	0
	244	Commission on Non-US MO	CPI	2.9100%	101	3		3	2.5900%	3	(0)	2.6100%	(0)
19	220	Contract Training Support	CPI	2.9100%	31,155	907		907	2.5900%	807	(100)	2.6100%	(3)
20	239	Domestic Indem	CPI	2.9100%	15,981	465	561	1,026	2.5900%	973	(53)	2.6100%	(1)
	240	International Indem	CPI	2.9100%	1,101	32	17	49	2.5900%	45	(4)	2.6100%	(0)
	242	Claims & Losses	CPI	2.9100%	94,380	2,746		2,746	2.5900%	2,444	(302)	2.6100%	(8)
Total					8,198,218	209,850	128,142	337,992		279,771	(58,221)		1,315

\1 Amount calculated by the Rollforward Model for Cost Level, Workload, Non-volume Workload, and Additional Workday.