

**BEFORE THE
POSTAL REGULATORY COMMISSION
WASHINGTON DC 20268-0001**

RATE ADJUSTMENT DUE TO)
EXTRAORDINARY OR EXCEPTIONAL) Docket No. R2010-4R
CIRCUMSTANCES)

**RESPONSE OF
OF ALLIANCE OF NONPROFIT MAILERS,
ASSOCIATION FOR POSTAL COMMERCE,
DIRECT MARKETING ASSOCIATION, AND
MAGAZINE PUBLISHERS OF AMERICA, INC.
TO USPS MOTION TO SUPPLEMENT RECORD
(November 14, 2011)**

The undersigned parties respond to the November 7 Motion Of The United States Postal Service For Leave To Supplement The Record (“Motion to Supplement”). This response is filed pursuant to the procedural schedule established in Order No. 864 (at 54-56) and extended in Order No. 937 (at 9-10). In this response, we discuss the threshold question of what workpapers and other supporting information the Postal Service should be required to produce before other parties are required to respond to the proffered evidence.

(1) The supplemental material proffered by the Postal Service falls into two main categories:

(a) First, the Postal Service asks leave to submit analyses purporting to quantify the contribution assertedly lost by the Postal Service as a result of the

2007-2009 recession. The Postal Service indicates that this material will consist of, or be based on, the “Method 5” “source of change” analysis that the Postal Service included in its July 25, 2011 comments. The analysis purported to show the volume losses by product that were due to the recession, multiplied by unit contribution from each product. USPS Motion For Leave To Supplement at 1; *see also* USPS Statement Regarding Exigent Request at 3-4 (citing USPS Comments (July 25, 2011) at 44-46; USPS responses to GCA interrogatories GCA/USPS-T2-1 and 2 in Docket No. N2010-1 and underlying Excel worksheets. The undersigned parties moved on July 27 to strike the material, and Order No. 781 directed the parties not to respond to this evidence in their reply comments of August 1, 2011.

(b) Second, the Postal Service asks leave to file “testimony explaining why rate increases equaling the net adverse financial impact quantified by the Postal Service are necessary, under best practices of honest, efficient, and economical management, to maintain and continue the development of postal services of the kind and quality adapted to the needs of the United States.”¹

(2) The claims embodied in the proffered material are broad and sweeping. If accepted by the Commission, they could cost users of the Postal Service’s market dominant products billions of dollars in added postage. Verifying and testing these claims—particularly those related to the volume losses by product that are due to the recession—will require access to a myriad of facts and methodological

¹ The Postal Service also seeks leave to submit “legal analysis in support of the above testimony.” Motion For Leave To Supplement at 1.

assumptions that are complex, difficult or impossible to verify or replicate from public data, and unavailable from sources other than the Postal Service. Accordingly, due process requires that (1) the Postal Service produce the underlying data, assumptions and workpapers to other parties and the Commission, and (2) interested parties have an adequate time to digest the supporting material—and obtain production of any material items that the Postal Service fails to include in its initial production—before adversely affected parties can be expected to respond. *See Newsweek, Inc. v. USPS*, 663 F.2d 1186, 1205 (2nd Cir. 1981), remanded on other grounds, *Nat'l Ass'n of Greeting Card Publishers v. USPS*, 462 U.S. 810 (1983) (overturning an adjustment to the Postal Service's revenue requirement based on briefs and comments solicited after the close of the record); *Mail Order Ass'n of America v. USPS*, 2 F.3d 408, 427-430 (D.C. Cir. 1993) (overturning cost findings based on a methodology adopted by the Commission without giving adverse parties an opportunity to scrutinize and challenge the methodology through discovery, cross-examination and rebuttal testimony); *Prometheus Radio Project v. FCC*, Nos. 03-3078 *et al.* (3rd Cir., July 7, 2011), 2011 U.S. App. LEXIS 13855, *34-40, 51-56 (allowing interested parties only 28 days to comment on new FCC proposal violated due process requirements for notice-and-comment rulemakings).

(3) The remainder of this pleading identifies by issue the key items that the Postal Service must produce before other parties can fairly be expected to respond. We reserve the right to seek additional information if the Postal Service's evidentiary filing includes other items not disclosed in its November 7 pleadings.

A. The Duration Of Any Exigent Rate Increase

(4) Perhaps the single most important issue raised by the Postal Service's filing is the duration of the exigent increase sought, for this threshold choice drives the scope and extent of the evidence that the Postal Service should be required to file on every other major issue.

(5) In its July 25 comments, the Postal Service asserted that an exigent increase, once authorized by the Commission, should be allowed to remain in effect indefinitely, with no termination date. USPS Comments (July 25, 2011) at 54-55. Under this theory, exigent rate increases presumably could also be included in the base rates to which future CPI-based rate adjustments would be applied. This would be grossly inappropriate. Any exigent increase authorized by the Commission should be established as a temporary surcharged of fixed duration, so that the total present value of the revenue generated by the increases does not exceed the total present value of the losses found recoverable under Section 3622(d)(1)(E). Moreover, the exigent increase may not be included in the base rates to which CPI adjustments are applied.

(6) As the PRC recognized in Order No. 864, exigent circumstances typically are of short duration, and certainly may not be assumed to last indefinitely. Order No. 864 at 66-68. There are two obvious reasons for this. First, recession-related volume declines reverse after a recession bottoms out. (The 2007-2009 recession, which began in December 2007, ended in June 2009. See National Bureau of Economic Research Business Cycle Dating Committee at

www.nber.org/cycles/sept2010html (accessed on November 8, 2011).) Second, the need for an exigent increase should diminish over time even if mail volume recovers slowly (or not at all) because the ability of a firm to adjust its operations and cost structures as well as shed excess capacity increases with the passage of time. A firm can downsize its costs by selling or subleasing real estate and other long-lived assets; by simply not replacing long-lived assets as they reach the end of their useful lives; by renegotiating, or not renewing, long-term supply contracts; and by reducing the size of its workforce through layoffs and attrition (and by renegotiating collective bargaining agreements as they expire).

(7) An exigent rate increase with no expiration date, however, implies that the exigent circumstances and the resulting losses in contribution will continue forever. Huge cost over-recovery would result. At a discount rate of 3.5 percent, for example, the total present value of a \$2.3 billion annual stream of payments is approximately *\$66 billion*.²

² The formula for the present value of a constant real stream of income is

$$PV = \frac{C}{(1+r)^1} + \frac{C}{(1+r)^2} + \frac{C}{(1+r)^3} \dots = \frac{C}{r}$$

where C is the amount of the annual income and r is the discount rate. As of June 30, 2011, the Postal Service used a discount rate of 3.5 percent for determining the present value of its workers compensation liability. USPS Form 10Q Report for 3rd Quarter 2011 (August 5, 2011) at 16.

(8) This over-recovery would violate multiple elements of 39 U.S.C. § 3622(d)(1)(E). The Postal Service would be receiving revenue to cover losses that (if they occurred at all) could not possibly be regarded as “due to” the 2007-2009 recession; which have not be shown to be “necessary” for continued operation of the Postal Service in those out-years; and which would directly violate the “reasonable and equitable” requirement of the statute.

(9) To avoid this unlawful over-recovery, any exigent rate increase proposed to the Commission should be defined as a temporary surcharge with a fixed termination date, and any such surcharge should be excluded from the base rates to which any CPI adjustment is applied. Moreover, the Postal Service should have the burden of separately satisfying each of the elements of 39 U.S.C. § 3622(d)(1)(E) for each year of the proposed term of the surcharge. Thus, for example, if the Postal Service seeks to have the surcharge remain in effect past the present year, the Postal Service should be required to produce its internal analyses of the revenue and contribution that the Postal Service expects to generate each year, and the annual opportunities available to the Postal Service to reduce its costs (e.g., the Postal Service’s internal studies of the cost savings that is projects could result from the Postal Service’s efforts to reduce its costs by \$20 billion by FY 2015.³

³ See <http://about.usps.com/news/electronic-press-kits/our-future-network/cost-reduction-by-2015.pdf>.

B. The Loss Of Volume Assertedly Caused By The Recession

(10) The heart of the Postal Service's loss claim is a "Source of Change" spreadsheet (developed using outputs from the Postal Service's demand equations) filed in response to an interrogatory in Docket No. N2010-1, the Five-Day Delivery proceeding. The interrogatory response (including the spreadsheet) was of no great consequence for the outcome of the case. Perhaps for this reason, the Commission did not require the Postal Service to document fully the contents and assumptions of the spreadsheet. Rather than produce all of the source data and programs used to prepare the spreadsheet and detailed methodological descriptions of those items, the Postal Service has disclosed only certain source data and referenced a five-year-old, three-page general description of how Source of Change spreadsheets were prepared five years ago (i.e., before the beginning of the 2007-2009 recession). USPS response to GCA interrogatories GCA/USPS-T2-1(b) in Docket No. N2010-1. Moreover, the individual cells of the Sources of Change spreadsheet are populated mainly with numerical values, not formulae, thereby significantly increasing the difficulty that interested parties will face in analyzing and testing the claimed relationships between the values. See N2010-1 spreadsheet GCA.1.Sources-of-Change.xls.

(11) This spreadsheet attempted to determine how much lower volumes (by product) were in FY 2009 because of the recession.⁴ The FY 2009 volume losses

⁴ Significantly, however, the analysis that the Postal Service filed in the present docket on July 25, 2011 was incomplete, focusing only on First-Class Mail and Standard Mail, and the demand equations were generally estimated at the subclass, not the product, level.

attributed to the recession were then multiplied by the unit contribution from each product. See Comments (July 25, 2011) at 44-46; USPS responses to GCA interrogatories GCA/USPS-T2-1 and 2 in Docket No. N2010-1 and underlying Excel worksheets.

(12) A critical first step is to specify what volumes the Postal Service assumes would have been mailed absent the recession: the difference between those assumed volumes and actual volumes is the recessionary volume loss. Overly rosy assumptions about the non-recessionary volumes obviously will overstate the resulting estimates of the decline in volume caused by the recession. Decomposing the decline in volume between the recession and other causes is a crucial step because, as the Postal Service has conceded, electronic diversion, and the volume and revenue losses that resulted from it, do not constitute extraordinary or exceptional circumstances under 39 U.S.C. § 3622(d)(1)(E):

Opponents of the Request emphasize that the diversion of mail volume to electronic alternatives is a long-term trend that does not qualify as an “extraordinary or exceptional circumstance.” Both the Postal Service and the Commission agree.

Order No. 547 at 51 & n. 3 (citing USPS Response to Motion to Dismiss at 13, n. 2); *accord*, Order No. 547 at 62 n. 50 (citing USPS Reply Comments at 17) (“The Postal Service is not claiming that either the volume loss attributable to electronic diversion or any statutory provision, including its obligation to prefund the RHBF, qualifies as an extraordinary or exceptional circumstance.”). This step, while crucial, is a “daunting proposition” (as the Postal Service has admitted), increasing

the need for testing and verification. USPS response to GCA interrogatories GCA/USPS-T2-1 in Docket No. N2010-1.

(13) The Postal Service's Source of Change analysis assumes that *all* volume changes associated with macroeconomic variables are recession-related. This assumption is quite unlikely, as indicated by the Postal Service's inclusion of both short-run (i.e., cyclical) and long-run (i.e., trend) macroeconomic factors in demand equations.⁵ The data on the effect of macroeconomic factors on mail volumes in the Postal Service's Source of Change analysis are not sufficiently disaggregated, however, to allow other parties to test the soundness of the assumption and its impact on the volume losses attributed to the recession. The USPS should be required to confirm that all mail volume changes due to macroeconomic variables were assumed to be recession-related and, if not, disclose, for each macroeconomic variable, the extent to which it has been assumed to be recession-related. The Postal Service must also provide the effect on mail volume of each macroeconomic factor individually, not (as the Postal Service's July 25 filing provided) just the aggregate effect of all macroeconomic factors combined.

(14) The Postal Service's demand equations make no direct observations of the volume of mail diverted to the Internet, but rather use a proxy estimate derived from variables for the number of Internet subscribers and changes in employment

⁵ See Narrative Explanation of Econometric Demand Equations for Market Dominant Products Filed with Postal Regulatory Commission on January 20, 2011 at 7-8 (filed at PRC on July 1, 2011).

levels. *See* Sources of Change data.zip (filed Jan. 20, 2010), “Econometric Demand Equations for Market Dominant Products as of January, 2010” at 2-3, 11. If the Postal Service generated other data bearing on this issue, they should be produced.

(15) This is not an exhaustive list of the undocumented data and assumptions underlying the Postal Service’s decomposition analysis. Rather than engage in a further guessing game, the Commission should direct the Postal Service to provide, for all of the analyses and other studies on which it seeks to rely, the information required by each provision of 39 C.F.R. § 3001.31(k), including but not limited to the information required for econometric studies by 39 C.F.R. § 3001.31(k)(2)(iv).

(16) The Postal Service should also be required to perform separate Source of Change analyses for FY 2008, FY 2009 and for the entire period of the recession. This is essential to enable other parties and the Commission to determine how much contribution was lost during the recession vs. afterwards.

(17) Finally, the Commission should also require the Postal Service to provide knowledgeable individuals for a technical conference on the Postal Service’s composition analyses.

C. The Loss Of Net Contribution Assertedly Caused By The Recession

(18) To quantify the financial effect of the recession, one must also convert changes in volume into changes in net contribution, since a decline in volume causes

the Postal Service to avoid the costs associated with the lost volume. The Postal Service's Source of Change analysis did not perform this conversion analysis; the regression results were limited to estimates of *pieces*: "No estimate has been made regarding the relative contribution of macroeconomic factors on Postal Service *revenues*." Docket No. N2010-1, USPS response to GCA/USPS-T2-1 (May 17, 2010) at 2 (emphasis added). Rather, the Postal Service applied separately derived contribution-per-piece values for each product, and then multiplied those values by the volume changes that the regression analyses attributed to the recession. Since demand equations are generally estimated at the subclass level, USPS also had to undertake a separate analysis to disaggregate subclass level volume losses by product (*e.g.*, Standard Mail Regular non-ECR volume losses had to be disaggregated by shape). How the Postal Service disaggregates subclass-level volume losses by product has huge implications because the unit contribution by product can vary substantially within a subclass, such as the former Standard Mail Regular.

D. Whether The Postal Service Would Need An Exigent Rate Increase Under Best Practices Of Honest, Efficient And Economical Management

(19) One of the elements that 39 U.S.C. § 3622(d)(1)(E) requires the Postal Service to establish for any exigent rate increase is a showing that the Postal Service would need more money to continue operating if it followed "best practices of honest, efficient, and economical management." Although the undersigned parties and others raised the issue during the first phase of this case, the

Commission found that resolving the issue was unnecessary because the Postal Service had failed to satisfy the threshold “due to” requirement. Order No. 547 at 26-27; Order No. 864 at 30. Hence, the argument must be resolved in this phase, as the Postal Service concedes. USPS Statement (Nov. 7, 2011) at 3.

(20) Whether the Postal Service would need the extra money it seeks if it had followed “best practices of honest, efficient, and economical management” is inherently difficult for adverse parties to litigate and the Commission to resolve. First, the question by definition entails an inquiry into the counterfactual. Would the Postal Service’s revenue needs be lower if it had moved more aggressively in recent years to (a) increase its contribution from competitive products, (b) close low-volume retail post offices, (c) consolidate mail processing plants, (d) reduce the compensation premium paid to postal workers and pursue the elimination of no-layoff clauses through collective bargaining—and, if necessary, arbitration? Second, critical information about mismanagement and missed opportunities is likely to be in the sole possession of the Postal Service.

(21) At the same time, a thorough inquiry into this issue is critical in any proceeding under 39 U.S.C. § 3622(d)(1)(E): an exigent rate case, by definition, is an attempt to circumvent the CPI cap, the primary mechanism established by Congress in 2006 to protect against the risk that the Postal Service could misuse its market power by recovering its costs through rate increases rather than effective cost control. Experience teaches that, without a searching inquiry into internal Postal Service studies and analyses on this issue, the Postal Service is likely to

submit glittering generalities about its management efficiency that are quite at odds with the facts. See Docket No. R2010-4, Tr. 1/59 & 116 (Corbett statement) (claiming that efficiency is “in the” Postal Service’s “DNA” (Tr. 1/59 & 116 (Corbett)); Docket No. N2010-1, Advisory Opinion On Elimination Of Saturday Delivery (March 24, 2011) at 1 (finding that the USPS had overstated the cost savings and understated the revenue loss from the elimination of five-day delivery); Order No. 718 in Docket No. C2009-1, *Complaint of GameFly, Inc.* (April 20, 2011) at ¶¶ 4156-4166, 4177-4203 (finding that testimony of the Postal Service’s witnesses that its decisions about manual vs. automated processing of DVD mailers maximized mail processing efficiency and reduced costs was refuted by internal USPS documents obtained by GameFly in discovery).

(22) For these reasons, the Postal Service should be directed to produce, simultaneously with its supplementary filing in this round of the case, copies of all studies and underlying calculations within the past three years (other than those that have already been produced to the public) assessing:

- (a) The effectiveness of past and proposed efforts to reduce major postal service costs, including but not limited to retail post offices, mail processing facilities, and labor costs (both head count and compensation levels).
- (b) The effectiveness of past and proposed efforts to increase Postal Service revenue or contribution from any major product.

E. Other Information

(23) Apart from the specific items discussed above, the Commission should direct the Postal Service, as part of its supplemental filing of evidence and argument, to file its entire case. The Postal Service should not be allowed to sandbag other parties by withholding material that is responsive to issues that a reasonable person would anticipate being raised by the Postal Service's case.

(24) The USPS states that it "possibly" may also submit unspecified additional "testimony or further legal analysis updating its prior submissions" on the issue of whether "rate increases equaling the quantified net adverse financial impact would be necessary, under best practices of honest, efficient, and economical management, to maintain and continue the development of postal services of the kind and quality adapted to the needs of the United States." The undersigned parties reserve the right to seek additional data or workpapers depending on the nature of the "testimony or further legal analysis" that the Postal Service chooses to file.

CONCLUSION

The undersigned parties respectfully request that the Commission condition acceptance of the supplemental material proffered by the Postal Service on the simultaneous filing of the specific items discussed above.

Respectfully submitted,

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