

**H.R. 22, THE POSTAL MODERNIZATION ACT OF
1999**

HEARINGS
BEFORE THE
SUBCOMMITTEE ON THE POSTAL SERVICE
OF THE
COMMITTEE ON GOVERNMENT REFORM
HOUSE OF REPRESENTATIVES
ONE HUNDRED SIXTH CONGRESS
FIRST SESSION
ON
H.R. 22

TO MODERNIZE THE POSTAL LAWS OF THE UNITED STATES

FEBRUARY 11, AND MARCH 4, 1999

Serial No. 106-16

Printed for the use of the Committee on Government Reform



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WASHINGTON : 1999

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H.R. 22, THE POSTAL MODERNIZATION ACT OF 1999

THURSDAY, FEBRUARY 11, 1999

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON THE POSTAL SERVICE,
COMMITTEE ON GOVERNMENT REFORM,
Washington, DC.

The subcommittee met, pursuant to notice, at 10 a.m., in room 2154, Rayburn House Office Building, Hon. John M. McHugh (chairman of the subcommittee) presiding.

Present: Representatives McHugh, Gilman, LaTourette, Burton, Fattah, and Davis of Illinois.

Staff present: Robert Taub, staff director; Heea Vazirani-Fales, counsel; Abigail Hurowitz, clerk; Jane Hatcherson, legislative assistant; Denise Wilson, minority professional staff member; and Jean Gosa, minority administrative staff assistant.

Mr. MCHUGH. The Subcommittee on the Postal Service will come to order. I would tell you this is the answer of my dreams. Every night I wake up and dream I'm sitting here and Chairman Burton's down there. And it's finally come true.

Let me welcome you here this morning to the first hearing of this subcommittee for the 106th Congress. I am happy to note that, with one exception, virtually all of the members of last year's Congress have remained on this subcommittee. Some cynics amongst you might suggest that's the legislative equivalent of life without parole. I would suggest, however, that it is a tribute to the work of this subcommittee and a tribute as well to the cooperative effort that we, in my opinion, have enjoyed now for some time.

To say that the purpose of our meeting here this morning is well stated would be an overstatement. If nothing else, the bill we're considering this morning, H.R. 22, is mature. I will not bore all of you with a recitation once again of what I feel are its main provisions, if not its main attractions.

[The text of H.R. 22 follows:]

106TH CONGRESS
1ST SESSION

H. R. 22

To modernize the postal laws of the United States.

IN THE HOUSE OF REPRESENTATIVES

JANUARY 6, 1999

MR. MCHUGH (for himself and Mr. BURTON of Indiana) introduced the following bill; which was referred to the Committee on Government Reform, and in addition to the Committee on the Judiciary, for a period to be subsequently determined by the Speaker, in each case for consideration of such provisions as fall within the jurisdiction of the committee concerned

A BILL

To modernize the postal laws of the United States.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE; TABLE OF CONTENTS.

(a) SHORT TITLE.—This Act may be cited as the "Postal Modernization Act of 1999".

(b) TABLE OF CONTENTS.—The table of contents for this Act is as follows:

Sec. 1. Short title; table of contents.

TITLE I—REDESIGNATION OF THE BOARD OF GOVERNORS, THE POSTMASTER GENERAL, AND THE POSTAL RATE COMMISSION

- Sec. 101. Redesignation of the Board of Governors.
- Sec. 102. Redesignation of the Postmaster General.
- Sec. 103. Redesignation of the Postal Rate Commission.
- Sec. 104. Other references.

TITLE II—NEW SYSTEM RELATING TO POSTAL RATES, CLASSES, AND SERVICES

Subtitle A—In General

- Sec. 201. Establishment.
- Sec. 202. Amendments to chapter 36.
- Sec. 203. Postal Service Competitive Products Fund.
- Sec. 204. USPS Corporation.
- Sec. 205. Postal and nonpostal products.

Subtitle B—Related Provisions

- Sec. 211. Authority for Postal Regulatory Commission to issue subpoenas.
- Sec. 212. Qualification requirements for Commissioners and Directors.
- Sec. 213. Appropriations for the Commission.
- Sec. 214. Change-of-address order involving a commercial mail receiving agency.
- Sec. 215. Rates for mail under former section 4358.

TITLE III—GENERAL AUTHORITY

- Sec. 301. Rulemaking authority.
- Sec. 302. General duties.
- Sec. 303. Employment of postal police officers.
- Sec. 304. Date of postmark to be treated as date of appeal in connection with the closing or consolidation of post offices.
- Sec. 305. Unfair competition prohibited.
- Sec. 306. International postal arrangements.
- Sec. 307. Suits by and against the Postal Service.

TITLE IV—MISCELLANEOUS PROVISIONS RELATING TO THE BUDGET AND APPROPRIATIONS PROCESS

- Sec. 401. Provisions relating to benefits under chapter 81 of title 5, United States Code, for officers and employees of the former Post Office Department.
- Sec. 402. Technical and conforming amendments.

TITLE V—PROVISIONS RELATING TO TRANSPORTATION, CARRIAGE, OR DELIVERY OF MAIL

- Sec. 501. Obsolete provisions.
- Sec. 502. Expanded contracting authority.
- Sec. 503. Private carriage of letters.
- Sec. 504. Repeal of section 5403.

TITLE VI—STUDIES

- Sec. 601. Employee-management relations.
- Sec. 602. Recommendations on universal postal services.
- Sec. 603. Study on equal application of laws to competitive products.
- Sec. 604. Greater diversity in Postal Service executive and administrative schedule management positions.
- Sec. 605. Plan for assisting displaced workers.
- Sec. 606. Contracts with women, minorities, and small businesses.

TITLE VII—INSPECTORS GENERAL

- Sec. 701. Inspector General of the Postal Regulatory Commission.
- Sec. 702. Inspector General of the United States Postal Service to be appointed by the President.

TITLE VIII—LAW ENFORCEMENT

Subtitle A—Amendments to Title 39, United States Code

- Sec. 801. Make Federal assault statutes applicable to postal contract employees.
- Sec. 802. Sexually oriented advertising.
- Sec. 803. Allow Postal Service to retain asset forfeiture recoveries.
- Sec. 804. Hazardous matter.

Subtitle B—Other Provisions

- Sec. 811. Stalking Federal officers and employees.
- Sec. 812. Nonmailability of controlled substances.
- Sec. 813. Enhanced penalties.
- Sec. 814. Postal burglary provisions.
- Sec. 815. Mail, money, or other property of the United States.

TITLE I—REDESIGNATION OF THE BOARD OF GOVERNORS, THE POSTMASTER GENERAL, AND THE POSTAL RATE COMMISSION

SEC. 101. REDESIGNATION OF THE BOARD OF GOVERNORS.

(a) AMENDMENTS TO TITLE 39, UNITED STATES CODE.—Title 39, United States Code, is amended—

(1) in sections 102, 202, 204, 205, 402, 414, 1005, 3604, 3621, 3623, 3624, 3625, 3628, 3641, and 3684, in the analysis for chapter 2 (in the items relating to sections 202 and 205, respectively), and in the analysis for chapter 36 (in the item relating to section 3625) by striking “Governors” each place it appears and inserting “Directors”; and

(2) in sections 202, 205, and 1002 by striking "Governor" each place it appears and inserting "Director".

(b) AMENDMENT TO THE FEDERAL SALARY ACT OF 1967.—Section 225(f)(E) of the Federal Salary Act of 1967 (2 U.S.C. 356(E)) is amended by striking "Governors of the Board of Governors of the United States Postal Service" and inserting "Directors of the Board of Directors of the United States Postal Service".

(c) AMENDMENTS TO TITLE 5, UNITED STATES CODE.—Title 5, United States Code, is amended in sections 8344(e) and 8468(c) by striking "Governor of the Board of Governors of the United States Postal Service" and inserting "Director of the Board of Directors of the United States Postal Service".

(d) AMENDMENTS TO THE ETHICS IN GOVERNMENT ACT OF 1978.—The Ethics in Government Act of 1978 (5 U.S.C. App.) is amended—

(1) in section 101(f)(6) by striking "Governor of the Board of Governors of the United States Postal Service" and inserting "Director of the Board of Directors of the United States Postal Service"; and

(2) in sections 103(c) and 106(b)(6) by striking "Governors of the Board of Governors of the United States Postal Service" and inserting "Directors of the Board of Directors of the United States Postal Service".

(e) AMENDMENTS TO TITLE 18, UNITED STATES CODE.—Title 18, United States Code, is amended in sections 1735 and 3061 by striking "Governors" each place it appears and inserting "Directors".

SEC. 102. REDESIGNATION OF THE POSTMASTER GENERAL.

(a) AMENDMENTS TO TITLE 39, UNITED STATES CODE.—Section 102 of title 39, United States Code, is amended by striking "and" at the end of paragraph (3), by striking the period at the end of paragraph (4) and inserting "; and", and by adding at the end the following:

"(5) 'Postmaster General' means the Postmaster General and Chief Executive Officer of the United States Postal Service appointed under section 202(a) of this title."

(b) AMENDMENTS TO THE ETHICS IN GOVERNMENT ACT OF 1978.—The Ethics in Government Act of 1978 (5 U.S.C. App.) is amended in sections 101(f)(6), 103(c), and 106(b)(6) by striking "Postmaster General" and inserting "Postmaster General and Chief Executive Officer of the United States Postal Service".

(c) AMENDMENTS TO TITLE 18, UNITED STATES CODE.—Title 18, United States Code, is amended in sections 501, 1703, 1704, and 1709 by striking "Postmaster General" each place it appears and inserting "Postmaster General and Chief Executive Officer of the United States Postal Service".

SEC. 103. REDESIGNATION OF THE POSTAL RATE COMMISSION.

(a) AMENDMENTS TO TITLE 39, UNITED STATES CODE.—Title 39, United States Code, is amended in sections 404, 1001, 1002, 2003, 3601, 3602, 3603, 3604, 3622, 3623, 3624, 3625, 3628, 3641, and 3661, in the analysis for chapter 36 (in the item relating to subchapter I), and in the heading for subchapter I of chapter 36 by striking "Postal Rate Commission" each place it appears and inserting "Postal Regulatory Commission".

(b) AMENDMENTS TO TITLE 5, UNITED STATES CODE.—Title 5, United States Code, is amended in sections 104(1), 306(f), 2104(b), 3371(3), 5314 (in the item relating to Chairman, Postal Rate Commission), 5315 (in the item relating to Members, Postal Rate Commission), 5514(a)(5)(B), 7342(a)(1)(A), 7511(a)(1)(B)(ii), 8402(c)(1), 8423(b)(1)(B), and 8474(c)(4) by striking "Postal Rate Commission" and inserting "Postal Regulatory Commission".

(c) AMENDMENT TO THE ETHICS IN GOVERNMENT ACT OF 1978.—Section 101(f)(6) of the Ethics in Government Act of 1978 (5 U.S.C. App.) is amended by striking "Postal Rate Commission" and inserting "Postal Regulatory Commission".

(d) AMENDMENT TO THE REHABILITATION ACT OF 1973.—Section 501(b) of the Rehabilitation Act of 1973 (29 U.S.C. 791(b)) is amended by striking "Postal Rate Office" and inserting "Postal Regulatory Commission".

(e) AMENDMENT TO TITLE 44, UNITED STATES CODE.—Section 3502(5) of title 44, United States Code, is amended by striking "Postal Rate Commission" and inserting "Postal Regulatory Commission".

SEC. 104. OTHER REFERENCES.

(a) BOARD OF GOVERNORS, ETC.—Whenever reference is made in any provision of law (other than this Act or a provision of law amended by this Act), regulation, rule, document, or other record of the United States to the Board of Governors of the United States Postal Service (or any Governor or Governors thereof), such reference shall be considered a reference to the Board of Directors of the United States Postal Service (or any Director or Directors thereof, as appropriate).

(b) POSTMASTER GENERAL.—Whenever reference is made in any provision of law (other than this Act or a provision of law amended by this Act), regulation, rule, document, or other record of the United States to the Postmaster General, such reference shall be considered a reference to the Postmaster General and Chief Executive Officer of the United States Postal Service.

(c) POSTAL RATE COMMISSION.—Whenever reference is made in any provision of law (other than this Act or a provision of law amended by this Act), regulation, rule, document, or other record of the United States to the Postal Rate Commission, such reference shall be considered a reference to the Postal Regulatory Commission.

TITLE II—NEW SYSTEM RELATING TO POSTAL RATES, CLASSES, AND SERVICES

Subtitle A—In General

SEC. 201. ESTABLISHMENT.

(a) IN GENERAL.—Title 39, United States Code, is amended by adding after chapter 36 the following:

“CHAPTER 37—NEW SYSTEM FOR ESTABLISHING POSTAL RATES, CLASSES, AND SERVICES

“SUBCHAPTER I—DEFINITIONS

“Sec.

“3701. Definitions.

“3702. Free mailing privileges unaffected.

“SUBCHAPTER II—BASELINE RATES

“3721. Determination of baseline rates.

“3722. Provisions relating to reduced-rate categories of mail.

“3723. Automatic termination of any rate case that may be pending.

“SUBCHAPTER III—RATES FOR PRODUCTS IN THE NONCOMPETITIVE CATEGORY OF MAIL

“3731. Applicability; definitions.

“3732. Limitations on rates.

“3733. Adjustment factor.

“3734. Action of the Board.

“SUBCHAPTER IV—RATES FOR PRODUCTS IN THE COMPETITIVE CATEGORY OF MAIL

“3741. Applicability; definition.

“3742. Action of the Board.

“3743. Provisions applicable to competitive products individually.

“3744. Provisions applicable to competitive products collectively.

“SUBCHAPTER V—MARKET TESTS OF EXPERIMENTAL PRODUCTS

“3751. Market tests of experimental noncompetitive products.

“3752. Market tests of experimental competitive products.

“3753. Large-scale market tests.

“3754. Adjustment for inflation.

“3755. Conversion to permanence.

“3756. Effective date.

“SUBCHAPTER VI—PROVISIONS RELATING TO THE INTRODUCTION AND CATEGORIZATION OF PRODUCTS

“3761. Criteria for the identification of noncompetitive and competitive products.

“3762. New noncompetitive products.

“3763. New competitive products.

“3764. Transfers of products between categories of mail.

“3765. Transition provisions for new or transferred noncompetitive products.

"SUBCHAPTER VII—REPORTING REQUIREMENTS AND RELATED PROVISIONS

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- "3772. Annual reports to the Commission.
- "3773. Annual determination of compliance.
- "3774. Other reports.

"SUBCHAPTER I—DEFINITIONS

"§ 3701. Definitions

"For purposes of this chapter:

"(1) **PRODUCT.**—The term 'product' means a class of mail or type of postal service, including—

"(A) a subclass or other similar subordinate unit thereof; and

"(B) the next level of subordinate units thereof (below the first level of subordinate units, as referred to in subparagraph (A)).

"(2) **RATE.**—The term 'rate', as used with respect to any products, includes fees for postal services.

"(3) **PRODUCT IN THE NONCOMPETITIVE CATEGORY OF MAIL.**—The term 'product in the noncompetitive category of mail' or 'noncompetitive product' means a product subject to subchapter III.

"(4) **PRODUCT IN THE COMPETITIVE CATEGORY OF MAIL.**—The term 'product in the competitive category of mail' or 'competitive product' means a product subject to subchapter IV.

"(5) **CONSUMER PRICE INDEX.**—The term 'Consumer Price Index' means the Consumer Price Index for All Urban Consumers published monthly by the Bureau of Labor Statistics of the Department of Labor.

"(6) **YEAR.**—The term 'year' means a fiscal year.

"§ 3702. Free mailing privileges unaffected

"Nothing in this chapter shall be considered to affect any free mailing privileges accorded under any of sections 3217 or 3403 through 3406.

"SUBCHAPTER II—BASELINE RATES

"§ 3721. Determination of baseline rates

"(a) **REQUIREMENT THAT A RATEMAKING REQUEST BE MADE.**—The Postal Service shall, during the 18-month period beginning on the date of enactment of this chapter, submit a request under section 3622 for a recommended decision by the Postal Regulatory Commission on rates for all products in the noncompetitive category of mail and all products in the competitive category of mail.

"(b) **POLICIES AND CRITERIA.**—The request under subsection (a) shall be made in accordance with the same policies and criteria as would otherwise apply in the case of a request made under section 3622, except that—

"(1) in applying section 3621, any determination of total estimated costs of the Postal Service shall be made without including any provision for contingencies; and

"(2) to the extent that any class of mail or kind of mailer under section 3626(a) is involved, such request shall be made in conformance with the requirements of section 3722.

"(c) **PROCEDURES FOR CONSIDERATION.**—

"(1) **IN GENERAL.**—Except as otherwise provided in subsection (b) or any other provision of this subchapter, the request made under subsection (a) shall be considered and acted on in the same way as any other request made under section 3622.

"(2) **ADDITIONAL AUTHORITY.**—For purposes of the request made under subsection (a), section 3622(b) shall be applied as if it had been amended by inserting after 'the policies of this title' the following: '(including the second sentence of section 3621)'.

"(d) **EFFECTIVE DATE OF ANY RATES ESTABLISHED PURSUANT TO REQUEST.**—All rates established pursuant to the request made under subsection (a) shall take effect as of the same date, determined in accordance with applicable provisions of chapter 36, but in no event later than the last day of the 18-month period beginning on the date on which such request is made.

"(e) **DEFINITION OF BASELINE RATES.**—

"(1) **IN GENERAL.**—Subject to section 3722(c), for purposes of this title, the baseline rate for each product shall be the rate in effect for such product as of the applicable date under paragraph (2), irrespective of whether—

“(A) any rate change is in fact requested for such product under subsection (a);

“(B) ratemaking proceedings are in fact completed by such date; or

“(C) the rate in effect for such product as of such date is a permanent or temporary one.

“(2) DATE AS OF WHICH BASELINE RATES ARE TO BE DETERMINED.—The applicable date under this paragraph shall be—

“(A) the date as of which any baseline rates, established pursuant to the request made under subsection (a), are to take effect in accordance with subsection (d); or

“(B) if subparagraph (A) does not apply (whether because proceedings under chapter 36 are not completed before the deadline under subsection (d) or otherwise), the last day of the 18-month period referred to in subsection (d).

“§ 3722. Provisions relating to reduced-rate categories of mail

“(a) DEFINITIONS.—For purposes of this section, the terms ‘costs attributable’ and ‘regular-rate category’ have the same meanings as are given them by section 3626(a).

“(b) REQUIREMENT.—

“(1) IN GENERAL.—Notwithstanding any other provision of this title (but subject to paragraph (3)), the rate established under this chapter for a product within a reduced-rate category of mail (as referred to in section 3721(b)(2)), including the baseline rate therefor (if applicable), may not exceed—

“(A) in the case of a competitive product, the rate described in paragraph (2); or

“(B) in the case of a noncompetitive product, the lesser of—

“(i) the rate described in paragraph (2); or

“(ii) the highest rate allowable for such product under subsection (c) or (d) of section 3732, whichever is less.

“(2) RATE DESCRIBED.—The rate described in this paragraph is, with respect to any product, the rate that would then be in effect for such product if established under section 3626(a) in conformance with the requirement that—

“(A) the estimated costs attributable (expressed on a per-unit basis) used in establishing such rate, not exceed

“(B) the estimated costs attributable (similarly expressed) used in establishing the rate that is to be concurrently in effect for the same product within the most closely corresponding regular-rate category.

“(3) NONCOMPETITIVE PRODUCT MINIMUM.—Nothing in this subsection shall be considered to waive the limitation set forth in section 3732(b) (relating to the minimum rate required for a noncompetitive product).

“(c) SELF-EXECUTING CORRECTION MECHANISM.—If the baseline rate for a product would not otherwise be in compliance with subsection (b), such rate shall be reduced by the minimum amount necessary in order to achieve compliance.

“§ 3723. Automatic termination of any rate case that may be pending

“To the extent that any proceedings relating to a request made under section 3622 before the date of enactment of this chapter remain pending as of such date of enactment, any further action taken in connection with such request shall be null and void.

“SUBCHAPTER III—RATES FOR PRODUCTS IN THE NONCOMPETITIVE CATEGORY OF MAIL

“§ 3731. Applicability; definitions

“(a) APPLICABILITY.—This subchapter applies with respect to the products in the first, second, third, and fourth baskets of products, respectively.

“(b) DEFINITIONS.—For purposes of this subchapter:

“(1) FIRST BASKET OF PRODUCTS.—The term ‘first basket of products’ means—

“(A) single-piece first-class letters (both domestic and international);

“(B) single-piece first-class cards (both domestic and international);

“(C) single-piece parcels (both domestic and international); and

“(D) special services.

“(2) SECOND BASKET OF PRODUCTS.—The term ‘second basket of products’ means all first-class mail not in the first basket of products.

“(3) THIRD BASKET OF PRODUCTS.—The term ‘third basket of products’ means periodicals.

"(4) FOURTH BASKET OF PRODUCTS.—The term 'fourth basket of products' means standard mail (except for parcel post).

"(c) RULE OF CONSTRUCTION.—

"(1) IN GENERAL.—Except as provided in paragraph (2), mail matter referred to in paragraphs (1) through (4) of subsection (b) shall, for purposes of such paragraphs, be considered to have the respective meanings given them under the mail classification schedule (as defined by section 3623) as of the effective date of this chapter.

"(2) UPDATES.—The Postal Regulatory Commission shall, whenever any relevant change occurs (whether pursuant to a product transfer under section 3764, the reclassification of a product under section 3623, or the introduction of a new noncompetitive product under section 3762), prescribe new lists of products within the respective baskets described in subsection (b). The revised lists shall indicate how and when any previous lists (including under subsection (b)) are superseded, and shall be published in the Federal Register.

"§ 3732. Limitations on rates

"(a) IN GENERAL.—Except as otherwise provided in this subchapter, the rate in effect for a noncompetitive product may not, during any year in a ratemaking cycle (as defined in section 3733(a))—

"(1) be less than the minimum rate required for such product in such year, as determined under subsection (b);

"(2) be greater than the maximum rate allowable for such product in such year, as determined under subsection (c); or

"(3) be changed by a percentage that would cause such rate to fall outside of the range allowable for such product in such year, as determined under subsection (d).

Nothing in paragraph (3) shall be considered to authorize the establishment of any rate less than the minimum rate required under paragraph (1) or greater than the maximum rate allowable under paragraph (2).

"(b) MINIMUM RATE REQUIRED.—For purposes of this section, the minimum rate required for a product in a year is the minimum rate which, if kept in effect for such product throughout the year (or, if implemented after the start of the year, throughout the remainder of the year, but taking into account all revenues from such product that are attributable to earlier periods in the same year) will be sufficient to ensure that such product will bear the direct and indirect postal costs attributable to such product for such year.

"(c) MAXIMUM RATE ALLOWABLE.—

"(1) IN GENERAL.—For purposes of this section, the maximum rate allowable for a product in a year shall be equal to the rate determined by increasing or decreasing (as applicable)—

"(A) the maximum rate allowable for such product under this subsection in the year preceding the year for which the maximum rate allowable is being determined (disregarding any rounding rules), by

"(B) the percentage adjustment applicable for the year for which the maximum rate allowable is being determined, as determined under paragraph (2).

"(2) PERCENTAGE ADJUSTMENT APPLICABLE.—For purposes of this section, the percentage adjustment applicable shall, for any year, be equal to—

"(A) the change in the Consumer Price Index for such year, adjusted by

"(B) the adjustment factor for such year.

"(3) DEFINITIONS.—For purposes of this section:

"(A) CHANGE IN THE CONSUMER PRICE INDEX.—The change in the Consumer Price Index for a year shall be equal to the percentage (expressed as a positive value, a negative value, or zero, as the case may be) by which the Consumer Price Index for the preceding year differs from the Consumer Price Index for the second preceding year.

"(B) CONSUMER PRICE INDEX FOR A YEAR.—The Consumer Price Index for a year is the average of the Consumer Price Index for the 12-month period ending on June 30th of such year.

"(C) ADJUSTMENT FACTOR.—The adjustment factor for any year shall be determined in accordance with section 3733.

"(4) SPECIAL RULE.—For purposes of determining the maximum rate allowable for any particular product during the first year of the first ratemaking cycle, paragraph (1)(A) shall be applied by substituting 'the baseline rate for such product' for 'the maximum rate allowable for such product under this sub-

section in the year preceding the year for which the maximum rate allowable is being determined (disregarding any rounding rules).

"(5) ROUNDING RULE.—The maximum rate allowable for a product within the first basket of products shall be equal to the rate determined for such product under this subsection (disregarding this paragraph), rounded to the nearest cent (rounding $\frac{1}{2}$ of a cent to the next higher cent).

"(d) RANGE ALLOWABLE.—For purposes of this section, the range allowable for a product in any year is the range delimited by—

"(1) a maximum rate equal to the rate determined by increasing or decreasing (as applicable)—

"(A) the rate last in effect for such product before the start of such year, by

"(B) the percentage equal to the percentage adjustment applicable with respect to such product for such year, plus 2 percent; and

"(2) a minimum rate equal to the rate determined by increasing or decreasing (as applicable)—

"(A) the rate last in effect for such product before the start of such year, by

"(B) the percentage equal to the percentage adjustment applicable with respect to such product for such year, minus 2 percent.

For purposes of applying paragraphs (1)(B) and (2)(B) in any year, the Board of Directors may, in a manner consistent with the policies of this title and the requirements of this subchapter, establish a single percentage which shall be lower than, and which shall be substituted for, the percentage adjustment applicable that would otherwise be applied under both of those paragraphs in such year. Such single percentage shall be the same for every product in the noncompetitive category.

"§ 3733. Adjustment factor

"(a) DEFINITION OF RATEMAKING CYCLE.—

"(1) IN GENERAL.—For purposes of this title, the term 'ratemaking cycle' means—

"(A) the 5-year period beginning on the first day of the second year beginning after the date as of which the baseline rates are determined under section 3721(e)(2); and

"(B) each 5-year period beginning on the day after the last day of the immediately preceding 5-year period under this subsection.

"(2) EARLIER COMMENCEMENT DATE.—The Postal Regulatory Commission may advance the commencement date of the first ratemaking cycle to the date which occurs 1 year earlier than the date that would otherwise apply under subparagraph (1)(A), but only if that earlier date does not precede the date as of which all requirements of this section have been completed with respect to such cycle.

"(b) PROCEDURES FOR DETERMINING ADJUSTMENT FACTOR.—

"(1) COMMENCEMENT OF PROCEEDINGS.—

"(A) IN GENERAL.—Except as provided in subparagraph (B), the Postal Regulatory Commission shall, beginning in September of the second year before the start of each ratemaking cycle, provide the opportunity for a hearing on the record under sections 556 and 557 of title 5 to the Postal Service, users of the mails, and an officer of the Commission who shall be required to represent the interests of the general public, with respect to the adjustment factor to be established for the upcoming ratemaking cycle.

"(B) EXCEPTION.—For purposes of the first hearing under this subsection, proceedings shall be commenced during the second month beginning on or after the date as of which the baseline rates are determined under section 3721(e)(2).

"(2) RULES OF PROCEEDINGS.—In order to conduct its proceedings with utmost expedition consistent with procedural fairness to the parties, the Commission may (without limitation) adopt rules which provide for—

"(A) the advance submission of written direct testimony;

"(B) the conduct of prehearing conferences to define issues, and for other purposes to insure orderly and expeditious proceedings;

"(C) discovery both from the Postal Service and the parties to the proceedings;

"(D) limitation of testimony; and

"(E) the conduct of the entire proceedings off the record with the consent of the parties.

"(3) PRINTING AND NOTICE REQUIREMENTS.—The Commission's decision and the record of the Commission's hearings shall be made generally available at

the time the decision is issued and shall be printed and made available for sale by the Public Printer within 10 days following the day the decision is issued.

“(4) TIMING.—

“(A) IN GENERAL.—Except as provided in subparagraph (B), all actions required of the Commission under this section, including those required under paragraph (3), shall be completed by the end of the year preceding the commencement of the ratemaking cycle to which the decision relates.

“(B) EXCEPTION.—In any case in which the Commission determines that the Postal Service has unreasonably delayed any proceedings under this section by failing to respond within a reasonable time to any lawful order of the Commission, the Commission may extend the deadline described in subparagraph (A) by one day for each day of such delay.

“(C) EFFECT OF DELAY ON RATEMAKING AUTHORITY.—No rate change for any noncompetitive product may take effect during any period of delay. For purposes of the preceding sentence, the term ‘period of delay’ means, in the circumstance described in subparagraph (B), the period beginning on the day following the original deadline (as described in subparagraph (A)) and ending on the date of the new deadline (as determined under subparagraph (B)).

“(c) REQUIREMENTS RELATING TO THE ESTABLISHMENT OF ADJUSTMENT FACTOR.—

“(1) IN GENERAL.—An adjustment factor shall be established in accordance with—

“(A) the policies of this title; and

“(B) the best evidence of likely Postal Service productivity, and of specific sources of cost savings to the Postal Service, during the ratemaking cycle to which an adjustment factor is to apply.

“(2) REQUIREMENT THAT ADJUSTMENT FACTOR BE A NEGATIVE VALUE OR ZERO.—

“(A) IN GENERAL.—Except as provided in subparagraph (B), an adjustment factor may be no greater than zero.

“(B) EXCEPTIONS.—A positive adjustment factor may be established only upon a written determination by the Postal Regulatory Commission that an exception to subparagraph (A) is necessary—

“(i) because of any new and significant statutorily imposed funding obligations not fully funded through appropriations; or

“(ii) because postal revenues during the upcoming ratemaking cycle would otherwise be insufficient to enable the Postal Service, 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.

A determination under clause (ii) shall take into account costs anticipated by the Postal Service for the period of time involved, such as wages, benefits, and transportation costs, consistent with the provisions of subsection (g).

“(d) SAME ADJUSTMENT FACTOR TO BE UNIFORMLY APPLIED TO ALL PRODUCTS.—For purposes of each year in a ratemaking cycle, the same adjustment factor shall apply—

“(1) to all baskets under section 3731; and

“(2) to all products within each such basket.

“(e) HOW AN ADJUSTMENT FACTOR IS TO BE EXPRESSED AND APPLIED.—

“(1) HOW AN ADJUSTMENT FACTOR IS TO BE EXPRESSED.—An adjustment factor established under this section shall be expressed as a percentage.

“(2) HOW AN ADJUSTMENT FACTOR IS TO BE APPLIED.—To adjust a change in the Consumer Price Index by an adjustment factor, the magnitude of the adjustment factor shall—

“(A) if the adjustment factor is a positive value, be added to the change in the Consumer Price Index; or

“(B) if the adjustment factor is a negative value, be subtracted from the change in the Consumer Price Index.

“(f) EXIGENT CIRCUMSTANCES.—

“(1) IN GENERAL.—Notwithstanding subsection (d), upon a majority vote of the members of the Board of Directors then holding office, the Postal Service may request the Postal Regulatory Commission to render a decision on changing the adjustment factor to be applied during the then current ratemaking cycle (after having previously been established under this section for such cycle).

“(2) CONDITIONS.—A request made under paragraph (1) may be granted only upon a written determination by the Commission that the change requested is justified by one or more of the same reasons as would justify the establishment of a positive adjustment factor (as set forth in subsection (c)(2)(B)).

“(3) EFFECT; DURATION.—A change granted under this subsection—

“(A) shall supersede the adjustment factor that would otherwise apply under this section (with appropriate changes to the respective limitations under paragraphs (2) and (3) of section 3732(a)); and

“(B) shall remain in effect for the rest of the ratemaking cycle involved, subject to paragraph (5).

“(4) EXPEDITED CONSIDERATION.—A request made under paragraph (1) shall be acted on under this section in the same manner as if initiated under subsection (b)(1), except that a decision on any such request shall be rendered not later than 6 months after the date on which the request is made.

“(5) FREQUENCY.—Nothing in this section shall be considered to limit the number of times this subsection may be invoked during a ratemaking cycle.

“(g) POSTAL REGULATORY COMMISSION NOT TO INTERFERE WITH COLLECTIVE BARGAINING.—It is the sense of the Congress that nothing in this section should restrict, expand, or otherwise affect any of the rights, privileges, or benefits of either employees of the United States Postal Service, or labor organizations representing employees of the United States Postal Service, under chapter 12 of this title, the National Labor Relations Act, any handbook or manual affecting employee labor relations within the United States Postal Service, or any collective bargaining agreement.

“§ 3734. Action of the Board

“(a) AUTHORITY TO ESTABLISH RATES.—The Board of Directors, with the written concurrence of a majority of all of the members of the Board then holding office, shall establish rates for products in the noncompetitive category of mail in accordance with the requirements of this subchapter and the policies of this title.

“(b) PROCEDURES.—

“(1) IN GENERAL.—Rates shall be established in writing, complete with a statement of explanation and justification.

“(2) PUBLICATION.—The Board shall cause each such decision (complete with the accompanying statement) and the record of the Board’s proceedings to be published in the Federal Register at least 45 days before the rate or rates to which they pertain are to take effect.

“(c) LIMITATIONS ON AUTHORITY.—

“(1) IN GENERAL.—Except as provided in paragraph (2)—

“(A) FREQUENCY.—Ratemaking authority under this section may not be exercised more than once for purposes of any year.

“(B) UNIFORM EFFECTIVE DATE.—All changes in rates pursuant to this section in a year shall take effect on the same date.

“(2) EXCEPTION FOR CHANGE DUE TO EXIGENT CIRCUMSTANCES.—

“(A) IN GENERAL.—If the maximum rate allowable for a product in a year changes pursuant to a request granted under section 3733(f), then, in the event that ratemaking authority under this section was previously exercised with respect to such product for such year, such rate may be modified, not more than once more in such year, based on the change in the maximum rate allowable (and the corresponding change in the range allowable).

“(B) UNIFORM EFFECTIVE DATE.—All changes in rates pursuant to this paragraph shall, to the extent based on the same set of changes (as referred to in subparagraph (A)), take effect beginning on the same date.

“SUBCHAPTER IV—RATES FOR PRODUCTS IN THE COMPETITIVE CATEGORY OF MAIL

“§ 3741. Applicability; definition

“(a) APPLICABILITY.—This subchapter applies with respect to—

“(1) priority mail;

“(2) expedited mail;

“(3) mailgrams;

“(4) international mail; and

“(5) parcel post;

except that this subchapter does not apply with respect to any product then currently in the noncompetitive category of mail.

“(b) DEFINITION.—For purposes of this subchapter, the term ‘costs attributable’, as used with respect to a product, means the direct and indirect postal costs attributable to such product.

“(c) RULE OF CONSTRUCTION.—

“(1) IN GENERAL.—Except as provided in paragraph (2), mail matter referred to in paragraphs (1) through (5) of subsection (a) shall, for purposes of such paragraphs, be considered to have the respective meanings given them under the mail classification schedule (as defined by section 3623) as of the effective date of this chapter.

“(2) UPDATES.—The Postal Regulatory Commission shall, whenever any relevant change occurs (whether pursuant to a product transfer under section 3764 or an action taken under section 3763), prescribe new lists of the products to which this subchapter applies. The revised lists shall indicate how and when any previous lists (including under subsection (a)) are superseded, and shall be published in the Federal Register.

“§ 3742. Action of the Board

“(a) AUTHORITY TO ESTABLISH RATES.—The Board of Directors, with the written concurrence of a majority of all of the members of the Board then holding office, shall establish rates for products in the competitive category of mail in accordance with the requirements of this subchapter and the policies of this title.

“(b) PROCEDURES.—Section 3734(b) shall apply with respect to rates and decisions under this section, except that for purposes of this section, section 3734(b) shall be applied by substituting ‘by such date before the effective date of any new rates as the Board considers appropriate’ for ‘at least 45 days before the rate or rates to which they pertain are to take effect’.

“(c) EFFECTIVE DATE.—

“(1) IN GENERAL.—Except as provided in paragraph (2), the ratemaking provisions of this subchapter shall be effective beginning with the rates to be established for the first year beginning on or after the date as of which the baseline rates are determined under section 3721(e)(2).

“(2) EXCEPTION.—The ratemaking provisions of this subchapter shall, with respect to all international mail as to which this subchapter applies, be effective beginning on the date as of which the baseline rates are determined under section 3721(e)(2), subject (until the entirety of this subchapter becomes effective in accordance with paragraph (1)) only to the requirement under section 3743(a).

“§ 3743. Provisions applicable to competitive products individually

“(a) IN GENERAL.—Rates for products in the competitive category of mail shall be established in a manner such that each such product shall bear the costs attributable to such product in such year.

“(b) TREATMENT OF SHORTFALLS.—If revenues derived from a competitive product in any year are not sufficient to meet the costs attributable to such product for such year, the shortfall shall be made up in accordance with section 3744(c)(1).

“(c) MANDATORY DISCONTINUANCE OF LOSS-MAKING PRODUCTS.—

“(1) IN GENERAL.—If a competitive product persistently fails to cover the costs attributable to such product, the Postal Regulatory Commission may, in accordance with procedures which the Commission shall prescribe and after considering all relevant circumstances, order the Postal Service to discontinue such product permanently.

“(2) PROCEDURES.—The procedures prescribed to carry out this subsection—

“(A) shall provide the opportunity for a hearing on the record under sections 556 and 557 of title 5 to the Postal Service, users of the mail, and an officer of the Commission who shall be required to represent the interests of the general public;

“(B) may include rules of proceedings that provide for any procedure or other matter listed under section 3733(b)(2); and

“(C) shall require that any final decision be accompanied by a statement setting forth the reasons therefor.

“§ 3744. Provisions applicable to competitive products collectively

“(a) COST-COVERAGE REQUIREMENT.—

“(1) IN GENERAL.—Rates for competitive products shall be established in a manner such that the cost-coverage ratio for all competitive products (collectively) shall, for each year to which this subchapter applies (as referred to in section 3742(c)), be at least equal to the cost-coverage ratio for such year for all competitive and noncompetitive products (collectively).

“(2) COST-COVERAGE RATIO.—For purposes of this section, the term ‘cost-coverage ratio’ means, for the products and year involved, the ratio that—

“(A) total revenues from those products in such year, bears to

“(B) total costs attributable to those products in such year.

“(b) ADJUSTMENT FOR SPECIAL CIRCUMSTANCES.—The Postal Regulatory Commission may, by rule, and in order to ensure that ratios under this section appropriately compensate for any significant and objective differences in the nature and composition of costs attributable to competitive and noncompetitive products, respectively, provide for the exclusion of such costs attributable as the Commission considers to be uniquely or disproportionately associated with either category of products.

“(c) SPECIAL RULES TO MAKE UP FOR CERTAIN SHORTFALLS.—

“(1) SUBTRACTION TO MAKE UP FOR ANY SHORTFALL DESCRIBED IN SECTION 3743(b).—In any year in which a shortfall described in section 3743(b) occurs in the case of any competitive product, an amount equal to the amount of such shortfall shall, for purposes of determining whether the requirement under subsection (a) has been satisfied in such year, be subtracted from total revenues derived from all competitive products (collectively) in such year. Nothing in the preceding sentence shall be considered to permit or require that the same amount be concurrently subtracted from total revenues derived from competitive and noncompetitive products (collectively).

“(2) SUBTRACTION TO MAKE UP FOR ANY SHORTFALL IN CONTRIBUTIONS TOWARD INSTITUTIONAL COSTS IN A PREVIOUS YEAR.—If, in any year, the requirement under subsection (a) is not met (determined applying the provisions of subsection (b), paragraph (1), and this paragraph based on any failure to satisfy subsection (a) in the previous year), the difference between the total revenues considered to have been derived from competitive products in the year involved (determined applying such provisions), and the minimum amount of total revenues from competitive products which would have been required in order to satisfy subsection (a) (determined applying such provisions), shall, for purposes of determining whether the requirement under subsection (a) is met in the following year, be subtracted from total revenues derived from competitive products (collectively) in such following year. Nothing in the preceding sentence shall be considered to permit or require that the same amount be concurrently subtracted from total revenues derived from competitive and noncompetitive products (collectively).

“(d) PHASEIN AUTHORITY.—If necessary in order to afford the Postal Service an opportunity to increase efficiency to competitive market levels, the Postal Regulatory Commission may, by written determination made as part of its first adjustment factor case under section 3733, provide for the phasein of subsection (a) over the course of the first ratemaking cycle. If the Commission grants relief under this subsection, it shall review the continuing need for and the extent of such relief annually.

“SUBCHAPTER V—MARKET TESTS OF EXPERIMENTAL PRODUCTS

“§ 3751. Market tests of experimental noncompetitive products

“(a) AUTHORITY.—

“(1) IN GENERAL.—The Postal Service may conduct market tests of experimental noncompetitive products in accordance with this section.

“(2) PROVISIONS WAIVED.—A product shall not, while it is being tested under this section, be subject to the requirements of section 3623 (relating to mail classification), section 3732 (relating to limitations on rates), or section 3762 (relating to new noncompetitive products).

“(b) CONDITIONS.—A product may not be tested under this section unless it satisfies each of the following:

“(1) SIGNIFICANTLY DIFFERENT PRODUCT.—The product is, from the viewpoint of mail users, significantly different from all products offered by the Postal Service within the 2-year period preceding the start of the test.

“(2) DOLLAR-AMOUNT LIMITATION.—The total revenues that are anticipated, or in fact received, by the Postal Service from such product do not exceed \$10,000,000 in any year, subject to section 3754.

“(3) MARKET DISRUPTION.—The introduction or continued offering of the product will not cause unreasonable market disruption (either for competitive or noncompetitive products).

“(4) CORRECT CATEGORIZATION.—The testing of the product under this section is consistent with the criteria under section 3761(b)(2).

“(c) NOTICE.—At least 30 days before initiating a market test under this section, the Postal Service shall file with the Postal Regulatory Commission and publish in

the Federal Register a notice setting out the basis for the Postal Service's determination that the market test is covered by this section and describing the nature and scope of the market test.

"(d) DURATION.—

"(1) IN GENERAL.—A market test of a product under this section may be conducted over a period of not to exceed 24 months.

"(2) EXTENSION AUTHORITY.—If necessary in order to determine the feasibility or desirability of a product being tested under this section, the Postal Regulatory Commission may, upon written application of the Postal Service (filed not later than 60 days before the date as of which the testing of such product would otherwise be scheduled to terminate under paragraph (1)), extend the testing of such product for not to exceed an additional 12 months.

"(e) CANCELLATION.—If the Postal Regulatory Commission at any time determines that a market test under this section fails, with respect to any particular product, to meet one or more of the conditions set forth in subsection (b), it may issue any order that would be allowable under section 3662(c)(6). A determination under this subsection shall be made in accordance with such procedures as the Commission shall by regulation prescribe.

"§ 3752. Market tests of experimental competitive products

"(a) AUTHORITY.—

"(1) IN GENERAL.—The Postal Service may conduct market tests of experimental competitive products in accordance with this section.

"(2) PROVISIONS WAIVED.—Any noncompliance with section 3743(a) (relating to costs-attributable requirement) on the part of a product shall not, if it occurs while such product is being tested under this section, be taken into account for purposes of any sanction or other action that might otherwise be permitted or required under any of the following:

"(A) Section 3662(c)(3) (relating to ordering the adjustment of rates to lawful levels pursuant to a rate complaint).

"(B) Section 3743(c) (relating to mandatory discontinuance of loss-making products).

"(C) Section 3773(e) (relating to use of profits).

"(3) PROVISIONS NOT WAIVED.—Nothing in this section shall be considered to permit or require the exclusion of any costs or revenues that are attributable to a product that is being tested under this section from any determination under section 3744 (relating to provisions applicable to competitive products collectively).

"(b) CONDITIONS.—A product may not be tested under this section unless it satisfies each of the following:

"(1) SIGNIFICANTLY DIFFERENT PRODUCT.—The product is, from the viewpoint of mail users, significantly different from all products offered by the Postal Service within the 2-year period preceding the start of the test.

"(2) DOLLAR-AMOUNT LIMITATION.—The total revenues that are anticipated, or in fact received, by the Postal Service from such product do not exceed \$10,000,000 in any year, subject to section 3754.

"(3) MARKET DISRUPTION.—The introduction or continued offering of the product will not cause unreasonable market disruption (either for competitive or noncompetitive products).

"(4) CORRECT CATEGORIZATION.—The testing of the product under this section is consistent with the criteria under section 3761(b)(2).

"(c) NOTICE.—

"(1) IN GENERAL.—At least 30 days before initiating a market test under this section, the Postal Service shall file with the Postal Regulatory Commission and publish in the Federal Register a notice setting out the basis for the Postal Service's determination that the market test is covered by this section and describing the nature and scope of the market test.

"(2) SAFEGUARDS.—The provisions of section 3604(g) shall be available with respect to any information required to be filed under paragraph (1) to the same extent and in the same manner as in the case of any matter described in section 3604(g)(1). Nothing in paragraph (1) shall be considered to permit or require the publication of any information as to which confidential treatment is accorded under the preceding sentence (subject to the same exception as set forth in section 3604(g)(3)).

"(d) DURATION.—

"(1) IN GENERAL.—A market test of a product under this section may be conducted over a period of not to exceed 24 months.

"(2) EXTENSION AUTHORITY.—If necessary in order to determine the feasibility or desirability of a product being tested under this section, the Postal Regulatory Commission may, upon written application of the Postal Service (filed not later than 60 days before the date as of which the testing of such product would otherwise be scheduled to terminate under paragraph (1)), extend the testing of such product for not to exceed an additional 12 months.

"(e) CANCELLATION.—If the Postal Regulatory Commission at any time determines that a market test under this section fails, with respect to any particular product, to meet one or more of the conditions set forth in subsection (b), it may issue any order that would be allowable under section 3662(c)(6). A determination under this subsection shall be made in accordance with such procedures as the Commission shall by regulation prescribe.

"§ 3753. Large-scale market tests

"(a) AUTHORITY.—The Postal Service may, in accordance with this section, conduct—

"(1) market tests involving any experimental noncompetitive product that would be allowable under section 3751 but for subsection (b)(2) thereof; and

"(2) market tests involving any experimental competitive product that would be allowable under section 3752 but for subsection (b)(2) thereof.

"(b) CONDITION.—Notwithstanding any other provision of this section, a product may not be tested under this section unless the total revenues that are anticipated, or in fact received, by the Postal Service from such product do not exceed \$100,000,000 in any year, subject to section 3754.

"(c) PROVISIONS WAIVED.—Section 3751(a)(2) shall apply with respect to an experimental noncompetitive product being tested under this section, and section 3752(a)(2) shall apply with respect to an experimental competitive product being tested under this section, as if such test were instead being conducted section 3751 or 3752, as the case may be.

"(d) REGULATIONS.—The Postal Regulatory Commission shall by regulation establish rules for the conduct of market tests under this section, including rules for the termination of any such test. In adopting rules under this subsection, the Commission shall consider such matters as—

"(1) the Postal Service's interest in the development and testing of new products with a minimum of regulatory impediments; and

"(2) the public interest in preventing unfair or disruptive competition.

"(e) DURATION.—

"(1) IN GENERAL.—A market test of a product under this section may be conducted over a period of not to exceed 24 months.

"(2) EXTENSION AUTHORITY.—If necessary in order to determine the feasibility or desirability of a product being tested under this section, the Postal Regulatory Commission may, upon written application of the Postal Service (filed not later than 60 days before the date as of which the testing of such product would otherwise be scheduled to terminate under paragraph (1)), extend the testing of such product for not to exceed an additional 12 months.

"§ 3754. Adjustment for inflation

"In the case of a year following the first year in which any testing under this subchapter is permitted, the dollar amount contained in sections 3751(b)(2), 3752(b)(2), and 3753(b), respectively, shall be adjusted at the same time and by the same percentage adjustment as the maximum rates allowable for noncompetitive products are adjusted pursuant to 3732(c) (but deeming the adjustment factor under paragraph (2)(B) thereof to be zero for purposes of this section).

"§ 3755. Conversion to permanence

"A request to have an experimental product under this chapter converted to a permanent one—

"(1) shall be made and acted on in conformance with applicable provisions of subchapter VI; and

"(2) shall be made by the Postal Service.

"§ 3756. Effective date

"Market tests under this subchapter may be conducted in any year beginning with the first year beginning on or after the date as of which the baseline rates are determined under section 3721(e)(2).

"SUBCHAPTER VI—PROVISIONS RELATING TO THE INTRODUCTION AND
CATEGORIZATION OF PRODUCTS

"§ 3761. Criteria for the identification of noncompetitive and competitive products

"(a) IN GENERAL.—Except as provided in subchapter V, no product may be offered until such product has been assigned to the noncompetitive or competitive category of mail, whichever is appropriate (and, if a noncompetitive product, its proper basket).

"(b) CRITERIA.—

"(1) IN GENERAL.—Determinations as to the category of mail to which any particular product should be assigned (whether in connection with a new product under section 3762 or 3763, the proposed transfer of a product under section 3764, or the proposed reclassification of an existing product under subchapter II of chapter 36) shall be made in conformance with paragraph (2).

"(2) CHARACTERISTICS BY CATEGORY.—The noncompetitive category of products shall embrace all products in the sale of which the Postal Service exercises sufficient market power that it can effectively set the price of such product substantially above costs or raise prices significantly without risk of losing business to other firms offering similar products, or that it can effectively set the price below competitive costs to forestall entry by new competitors or to eliminate existing competitors. The competitive category of products shall embrace all other products.

"(c) INITIAL AND UPDATED LISTS.—The respective products which, as of any particular date, are within the noncompetitive or competitive category of mail (and any particular basket, if applicable) shall be as identified under sections 3731 and 3741.

"§ 3762. New noncompetitive products

"(a) REQUEST.—The Postal Service—

"(1) may from time to time request that the Postal Regulatory Commission submit a recommended decision on the classification for a new noncompetitive product; and

"(2) shall, as part of any request made under paragraph (1) (other than in the case of a transferred product), also request a recommended decision on the baseline rate for such product for purposes of section 3765.

"(b) HEARINGS.—In response to any request made by the Postal Service under this section, the Postal Regulatory Commission shall promptly initiate a proceeding in accordance with the procedures set out in section 3624.

"(c) FACTORS AND RECOMMENDED DECISION.—The Postal Regulatory Commission shall make a recommended decision on (1) the baseline rate for the new product based on the factors set out in section 3622(b), and (2) the classification for the new product based on the factors and requirements under section 3623(b). Such recommended decision shall be submitted to the Directors for action in accordance with section 3625, and subject to review in accordance with section 3628(a).

"§ 3763. New competitive products

"(a) AUTHORITY.—The Postal Service may, in accordance with this section, offer a new competitive product and, with respect to competitive products only, otherwise make changes in the mail classification schedule.

"(b) CONDITIONS.—An action under this section may not be taken unless it satisfies each of the following:

"(1) CRITERIA.—To the extent that the classification of a product is involved, the action would be consistent with the criteria under section 3761(b)(2).

"(2) COSTS ATTRIBUTABLE.—To the extent that the establishment of a rate for a competitive product is involved, the requirement under section 3743(a) would be met.

"(c) NOTICE.—

"(1) IN GENERAL.—At least 30 days before it offers a new competitive product or otherwise makes any change in the mail classification schedule under this section, the Postal Service shall file with the Postal Regulatory Commission and publish in the Federal Register a notice setting out the basis for the Postal Service's determination that the product satisfies each of the conditions under subsection (b).

"(2) SAFEGUARDS.—The provisions of section 3604(g) shall be available with respect to any information required to be filed under paragraph (1) to the same extent and in the same manner as in the case of any matter described in section 3604(g)(1). Nothing in paragraph (1) shall be considered to permit or require the publication of any information as to which confidential treatment is accorded

under the preceding sentence (subject to the same exception as set forth in section 3604(g)(3)).

“(d) CANCELLATION.—If the Postal Regulatory Commission determines that an action proposed to be taken under this section fails to meet either of the conditions set forth in subsection (b), the Commission shall, before the proposed action is scheduled to be taken or to commence (as applicable), order that the proposed action be canceled. A determination under this subsection shall be made in accordance with such procedures as the Commission shall by regulation prescribe.

“§ 3764. Transfers of products between categories of mail

“(a) IN GENERAL.—Upon request of the Postal Service or users of the mails, or upon its own initiative, the Postal Regulatory Commission may, after proceedings conducted in conformity with subsection (d), transfer 1 or more products—

“(1) from the noncompetitive category of mail to the competitive category of mail; or

“(2) from the competitive category of mail to the noncompetitive category of mail.

“(b) CRITERIA.—

“(1) IN GENERAL.—A decision under this section shall be made in accordance with the policies of this title and the criteria set forth in section 3761(b)(2).

“(2) EXCLUSION OF PRODUCTS COVERED BY POSTAL MONOPOLY.—A product covered by the postal monopoly shall not be subject to transfer under this section from the noncompetitive category of mail. For purposes of the preceding sentence, the term ‘product covered by the postal monopoly’ means any product the conveyance or transmission of which, under section 1696 of title 18, is reserved to the United States, subject to the same exception as set forth in the last sentence of section 409(d)(1).

“(3) ADDITIONAL CONSIDERATIONS.—In making any decision under this section, due regard shall be given to—

“(A) the availability and nature of enterprises in the private sector engaged in the delivery of the product involved; and

“(B) the views of those who use the product involved on the appropriateness of the proposed action.

“(c) TRANSFERS OF SUBCLASSES AND OTHER SUBORDINATE OR FURTHER SUBORDINATE UNITS ALLOWABLE.—Nothing in this title shall be considered to prevent transfers under this section from being made by reason of the fact that they would involve only some (but not all) of the subclasses or other subordinate or further subordinate units of the class of mail or type of postal service involved.

“(d) REQUIREMENTS.—Proceedings required to be conducted in accordance with this subsection—

“(1) shall provide the opportunity for a hearing on the record under sections 556 and 557 of title 5 to the Postal Service, users of the mail, and an officer of the Postal Regulatory Commission who shall be required to represent the interests of the general public;

“(2) may include rules of proceedings that provide for any procedure or other matter listed under section 3733(b)(2); and

“(3) shall require that any final decision be accompanied by a statement setting forth the reasons therefor.

Paragraph (3) of section 3733(b) (relating to printing and notice requirements) shall apply with respect to each Commission decision and related record of Commission hearings under this section.

“§ 3765. Transition provisions for new or transferred noncompetitive products

“(a) IN GENERAL.—In the case of a product that becomes assigned to the noncompetitive category of mail under section 3762 or that is transferred from the competitive to the noncompetitive category of mail under section 3764—

“(1) the maximum rate initially allowable for such product after that assignment or transfer shall be determined in accordance with subsection (b); and

“(2) the initial range allowable for such product after that assignment or transfer shall be determined in accordance with subsection (c).

“(b) MAXIMUM RATE INITIALLY ALLOWABLE.—The maximum rate allowable during the first year in which a product subject to this subsection is offered shall be determined in a manner similar to the special rule under section 3732(c)(4), subject to the following:

“(1) TRANSFERRED PRODUCTS.—In the case of any product that becomes a noncompetitive product pursuant to a transfer under section 3764, the rate last

in effect for such product (before the effective date of its transfer) shall be treated as its 'baseline rate'.

"(2) OTHER PRODUCTS.—In the case of any product assigned to the non-competitive category of mail pursuant to section 3762, the 'baseline rate' for such product shall be determined under subchapter II of chapter 36 pursuant to the request made under section 3762(a)(2) with respect thereto.

(c) RANGE INITIALLY ALLOWABLE.—The range allowable during the first year in which a product subject to this subsection is offered shall be determined in accordance with section 3732(d), deeming the rate determined for such product under subsection (b) of this section to be the rate specified by paragraphs (1)(A) and (2)(A) of section 3732(d).

"SUBCHAPTER VII—REPORTING REQUIREMENTS AND RELATED PROVISIONS

"§ 3771. Annual reports by the Commission

"(a) IN GENERAL.—The Postal Regulatory Commission shall render an annual report to the President and the Congress concerning the operations of the Commission under this title.

"(b) ADDITIONAL INFORMATION.—In addition to the information required under subsection (a), each report under this section shall also include, with respect to the period covered by such report, an estimate of the costs incurred by the Postal Service in providing—

"(1) postal services to areas of the Nation where, in the judgment of the Postal Regulatory Commission, the Postal Service either would not provide services at all or would not provide such services in accordance with the requirements of this title if the Postal Service were not required to provide prompt, reliable, and efficient services to patrons in all areas and all communities, including as required under the first sentence of section 101(b);

"(2) free or reduced rates for postal services as required by this title; and

"(3) other public services or activities which, in the judgment of the Postal Regulatory Commission, would not otherwise have been provided by the Postal Service but for the requirements of law.

The Commission shall detail the bases for its estimates and the statutory requirements giving rise to the costs identified in each report under this section.

"(c) INFORMATION FROM POSTAL SERVICE.—The Postal Service shall provide the Postal Regulatory Commission with such information as may, in the judgment of the Commission, be necessary in order for the Commission to prepare its reports under this section.

"§ 3772. Annual reports to the Commission

"(a) COSTS, REVENUES, AND RATES.—

"(1) IN GENERAL.—Except as provided in subsection (c), the Postal Service shall, no later than 90 days after the end of each year, prepare and submit to the Postal Regulatory Commission a report (together with such nonpublic annex thereto as the Commission may require under subsection (e)) analyzing costs, revenues, and rates in sufficient detail to demonstrate that the rates in effect for all products during such year (including, for purposes of section 3744, rates for all competitive products collectively) complied with all applicable requirements of this title.

"(2) AUDITING REQUIREMENT.—Before submitting a report (and any annex thereto) under paragraph (1), the Postal Service shall have the information contained in such report (and annex) audited by the Inspector General. The results of any such audit shall be submitted along with the report to which it pertains.

"(b) QUALITY OF SERVICES.—Except as provided in subsection (c), the Postal Service shall, no later than 90 days after the end of each year, prepare and submit to the Postal Regulatory Commission a report (together with such nonpublic annex thereto as the Commission may require under subsection (e)) which shall, for each noncompetitive product provided in such year, provide—

"(1) market information, including mail volumes; and

"(2) measures of the speed and reliability of postal service, including—

"(A) the service standard applicable to such product;

"(B) the actual level of service (described in terms of speed of delivery and reliability) provided; and

"(C) the degree of customer satisfaction with the service provided.

"(c) MARKET TESTS.—In carrying out subsections (a) and (b) with respect to experimental products offered through market tests under subchapter V in a year—

"(1) the Postal Service may, to the extent that a test under section 3751 or 3752 is involved, report summary data on the costs, revenues, and quality of service by market test; and

"(2) the Postal Service shall, to the extent that a test under section 3753 is involved, report such data as the Postal Regulatory Commission requires.

"(d) SUPPORTING MATTER.—The Postal Regulatory Commission shall have access, in accordance with such regulations as the Commission shall prescribe, to the working papers and any other supporting matter of the Postal Service and the Inspector General in connection with any information submitted under this section.

"(e) CONTENT AND FORM OF REPORTS.—

"(1) IN GENERAL.—The Postal Regulatory Commission shall, by regulation, prescribe the content and form of the public reports (and any nonpublic annex and supporting matter relating thereto) to be provided by the Postal Service under this section. In carrying out this subsection, the Commission shall give due consideration to—

"(A) providing the public with adequate information to assess the lawfulness of rates charged;

"(B) avoiding unnecessary or unwarranted administrative effort and expense on the part of the Postal Service; and

"(C) protecting the confidentiality of commercially sensitive information.

"(2) REVISED REQUIREMENTS.—The Commission may, on its own motion or on request of an interested party, initiate proceedings (to be conducted in accordance with regulations that the Commission shall prescribe) to improve the quality, accuracy, or completeness of postal service data required by the Commission under this subsection whenever it shall appear that—

"(A) the attribution of costs or revenues to postal products has become significantly inaccurate or can be significantly improved;

"(B) the quality of service data has become significantly inaccurate or can be significantly improved; or

"(C) such revisions are, in the judgment of the Commission, otherwise necessitated by the public interest.

"(f) CONFIDENTIAL INFORMATION.—

"(1) IN GENERAL.—If the Postal Service determines that any document or portion of a document, or other matter, which it provides to the Postal Regulatory Commission in a nonpublic annex under this section or pursuant to subsection (d) contains information which is described in section 410(c) of this title, or exempt from public disclosure under section 552(b) of title 5, the Postal Service shall, at the time of providing such matter to the Commission, notify the Commission of its determination, in writing, and describe with particularity the documents (or portions of documents) or other matter for which confidentiality is sought and the reasons therefor.

"(2) TREATMENT.—Any information or other matter described in paragraph (1) to which the Commission gains access under this section shall be subject to paragraphs (2) and (3) of section 3604(g) in the same way as if the Commission had received notification with respect to such matter under section 3604(g)(1).

"(g) OTHER REPORTS.—The Postal Service shall submit to the Postal Regulatory Commission, together with any other submission that it is required to make under this section in a year, copies of its then most recent—

"(1) comprehensive statement under section 2401(e);

"(2) performance plan under section 2803; and

"(3) program performance reports under section 2804.

"§ 3773. Annual determination of compliance

"(a) PROFITS DEFINED.—For purposes of this section, the term 'profits', with respect to a year, means the amount by which—

"(1) total revenues of the Postal Service attributable to such year, exceeds

"(2) total costs of the Postal Service (including institutional costs) attributable to such year,

as determined based on the report under section 3772(a) for such year.

"(b) OPPORTUNITY FOR PUBLIC COMMENT.—After receiving the reports required under section 3772 for any year, the Postal Regulatory Commission shall promptly provide an opportunity for comment on such reports by users of the mails, affected parties, and an officer of the Commission who shall be required to represent the interests of the general public.

"(c) DETERMINATION OF COMPLIANCE.—Not later than 90 days after receiving the submissions required under section 3772 with respect to a year, the Postal Regulatory Commission shall make a written determination as to whether—

"(1) any rates or fees in effect during such year (for products individually or collectively) were not in compliance with applicable provisions of this title;

"(2) any performance goals established under section 2803 or 2804 for such year were not met; and

"(3) any noncompetitive product failed to meet any service standard during such year.

"(d) IF NO NONCOMPLIANCE IS FOUND.—If, for a year, no instance of noncompliance is determined under subsection (c) (or no determination under subsection (c) is timely made), then, up to 100 percent of the profits attributable to such year (if any) may be used by the Postal Service for the purposes described in subsection (f).

"(e) IF ANY NONCOMPLIANCE IS FOUND.—If, for a year, a timely determination of noncompliance is made under subsection (c)—

"(1)(A) the Postal Regulatory Commission may order, based on the nature, circumstances, extent, and seriousness of the noncompliance, that a specific percentage (not to exceed 50 percent) of the profits attributable to such year (if any) be set aside for the purposes described in subsection (g); and

"(B) the remainder (or any portion) of those profits may be used by the Postal Service for the purposes described in subsection (f); and

"(2) the Commission may, in the case of any violation as to which a remedy could be ordered by the Commission under section 3662(c), order any such remedy under this section.

"(f) BONUSES.—

"(1) IN GENERAL.—The Postal Service shall establish a program under which cash bonuses may be paid to officers and employees of the Postal Service out of any profits which are available for that purpose.

"(2) REQUIREMENTS.—Under the program—

"(A) bonuses may be paid to officers and employees of the Postal Service under criteria which shall be fair and equitable;

"(B) the sole source of funding shall be any profits from any year, subject to the application of subsection (e)(1) with respect to such year; and

"(C) bonuses shall not be precluded (in whole or in part) by the limitation on compensation under the last sentence of section 1003(a) in a year, if—

"(i) total profits attributable to the preceding year, exceed

"(ii) the amount equal to 1 percent of total revenues of the Postal Service attributable to such preceding year.

"(3) DISCRETIONARY NATURE OF PROGRAM.—Nothing in this section shall be considered to create any entitlement to receive bonuses or to require that any portion of the profits from any year be used for bonuses in excess of whatever amount the Postal Service, in its sole discretion, considers appropriate.

"(4) CONSIDERATIONS RELATING TO THE PORTION OF PROFITS TO BE AVAILABLE FOR BONUSES.—In any decision relating to what portion of the available profits from any year shall be made available or used for bonuses under this subsection, there shall be taken into consideration—

"(A) the obligation on the part of the Postal Service to provide efficient and economical postal services in accordance with this title; and

"(B) the question of what portion of those profits (if any) should be used—

"(i) to retire debts or other obligations of the Postal Service;

"(ii) to limit future increases in postal rates or fees for products in the noncompetitive category of mail; or

"(iii) to carry out any other purpose.

"(g) DEDICATION OF FUNDS TOWARD REDUCING RATES AND FEES.—

"(1) IN GENERAL.—Any amounts ordered to be set aside under subsection (e)(1)(A) may not be used for any purpose other than to defray increases in future rates and fees for products in the noncompetitive category of mail or to reduce the rates and fees already in effect for such products.

"(2) COMPLIANCE.—Whenever an order under paragraph (1)(A) or (2) of subsection (e) is issued, the Postal Service shall include in its next comprehensive statement under section 2401(e) (and each subsequent statement thereunder until such order has been fully complied with) a statement as to—

"(A) what measures have been or will be implemented in order to comply with the order, including the schedule in accordance with which any amounts set aside pursuant to an order issued under subsection (e)(1)(A) shall be used or made available for the purposes described in paragraph (1); and

"(B) if (or to the extent that) an order under subsection (e)(1)(A) is involved—

“(i) the amount of savings actually passed on to mailers during the reporting period (whether through reduced rates and fees or otherwise), as compared to the amount of savings scheduled to have been passed on to mailers during such period; and

“(ii) to the extent that the amount of savings actually passed on to mailers is less than the amount scheduled to have been passed on to mailers during a reporting period, what measures (if any) have been or will be implemented to reconcile the difference.

“(3) NONREDUNDANT INFORMATION.—Nothing in paragraph (2) shall be considered to require that the same information be reported if included in a previous report under this subsection.

“(h) REPORTING REQUIREMENT RELATING TO BONUSES.—Included in its comprehensive statement under section 2401(e) for any period shall be—

“(1) the name of each person receiving a bonus during such period which would not have been allowable but for the provisions of subsection (f)(2)(C);

“(2) the amount of the bonus; and

“(3) the amount by which the limitation referred to in subsection (f)(2)(C) was exceeded as a result of such bonus.

“§ 3774. Other reports

“The Postal Regulatory Commission shall, at least every 6 years, render a report to the President and the Congress concerning—

“(1) the operation of the system consisting of chapter 36 and this chapter; and

“(2) recommendations for any legislation or other measures necessary to improve the effectiveness or efficiency of that system.”

(b) CLERICAL AMENDMENT.—The table of chapters for part IV of title 39, United States Code, is amended by adding at the end the following:

“37. New System for Establishing Postal Rates, Classes, and Services..... 3701”.

SEC. 202. AMENDMENTS TO CHAPTER 36.

(a) AUTHORITY TO FIX RATES AND CLASSES.—Section 3621 of title 39, United States Code, is amended—

(1) in the first sentence by striking “this chapter” and inserting “this chapter and chapter 37”; and

(2) by repealing the last 2 sentences.

(b) RATES AND FEES.—

(1) IN GENERAL.—The first sentence of section 3622(a) of title 39, United States Code, is amended to read as follows: “Whenever necessary in order to provide for the establishment of any baseline rate needed for purposes of section 3762(a) (relating to certain new noncompetitive products), the Postal Service shall request the Postal Regulatory Commission to submit a recommended decision on changes in a rate or rates of postage or in a fee or fees for postal services in accordance with the policies of this title and applicable provisions of chapter 37.”

(2) CONFORMING AMENDMENTS.—Such section 3622(a) is further amended—

(A) by striking “(a)” and inserting “(a)(1)”; and

(B) by adding at the end the following:

“(2) A request under this subsection may not be submitted except in the circumstance described in paragraph (1).”

(c) MAIL CLASSIFICATION.—

(1) REPEAL.—Section 3623 of title 39, United States Code, is amended by striking subsection (a) and by redesignating subsections (b) through (d) as subsections (a) through (c), respectively.

(2) MODIFIED AUTHORITY.—Subsection (a) of section 3623 of title 39, United States Code, as so redesignated by paragraph (1), is amended to read as follows:

“(a) The Postal Service may from time to time request that the Postal Regulatory Commission submit, or the Commission may submit to the Directors on its own initiative, a recommended decision on changes in the mail classification schedule for noncompetitive products (within the meaning of subchapter III of chapter 37).”

(d) RECOMMENDED DECISIONS OF COMMISSION.—Subsection (c) of section 3624 of title 39, United States Code, is amended—

(1) in paragraph (1) by striking “a request under section 3622 of this title for a recommended decision by the Commission on changes in a rate or rates of postage or in a fee or fees for postal services” and inserting “a request under

section 3623 for a recommended decision by the Commission on changes in the mail classification schedule or a request under section 3762 for a recommended decision by the Commission on the baseline rate and classification for a new noncompetitive product.”; and

(2) in paragraph (2) by striking “3622” and inserting “3623 or 3762 (as applicable)”.

(e) APPELLATE REVIEW.—

(1) APPEALABILITY OF ADJUSTMENT FACTOR AND PRODUCT TRANSFER DECISIONS.—The first sentence of section 3628 of title 39, United States Code, is amended—

(A) by striking “A decision” and inserting “(a) A decision”;

(B) by inserting before “may be appealed” the following: “on a request made under section 3623 or 3762, and any final decision by the Commission under section 3733 or 3764.”; and

(C) by striking “3624(a) of this title” and inserting “3624(a), 3733(b), 3762(b), or 3764(d) (as the case may be)”.

(2) APPEALS FROM ALL OTHER FINAL ORDERS OF THE COMMISSION.—

(A) TITLE 39 AMENDMENT.—Section 3628 of title 39, United States Code, is amended by adding at the end the following:

“(b) Any proceeding to enjoin, set aside, annul, or suspend any order of the Postal Regulatory Commission (except any order appealable under subsection (a)) shall be brought as provided by and in the manner prescribed in chapter 158 of title 28.”.

(B) TITLE 28 AMENDMENTS.—

(i) DEFINITIONS.—Subparagraph (A) of section 2341(3) of title 28, United States Code, is amended by inserting “the Postal Regulatory Commission,” after “the Federal Maritime Commission.”.

(ii) ORDERS APPEALABLE.—Section 2342 of title 28, United States Code, is amended by striking “and” at the end of paragraph (6), by striking the period at the end of paragraph (7) and inserting “; and”, and by adding at the end the following:

“(8) all final orders of the Postal Regulatory Commission made reviewable by section 3628(b) of title 39.”.

(3) CONFORMING AMENDMENTS.—Sections 3625 and 3681 of title 39, United States Code, are amended by striking “3628” each place it appears and inserting “3628(a)”.

(f) TEMPORARY RATES AND CLASSES.—

(1) NEGOTIATED SERVICE AGREEMENTS.—Section 3641 of title 39, United States Code, is amended to read as follows:

“§3641. Negotiated service agreements

“(a) The Postal Service may enter into negotiated service agreements with users of postal services in accordance with this section. A negotiated service agreement under this section shall—

“(1) pertain exclusively to products in the noncompetitive category of mail (within the meaning of subchapter III of chapter 37);

“(2) require that the contracting mail user perform mail preparation, processing, transportation, administration, or other functions that are in addition to or greater than those required of mailers under provisions of the mail classification schedule established pursuant to section 3623(b);

“(3) provide for the payment by the contracting mail user of liquidated damages to the Postal Service for nonperformance or breach of any of the material terms of the agreement, including any minimum volume commitments; the amount of such liquidated damages shall not be less than the difference between postage and fees paid by such mail user pursuant to the agreement and the amounts such user would have paid under the otherwise applicable schedule of rates and fees;

“(4) be for a term of not to exceed 3 years; and

“(5) provide that such agreement, and any amendment or renewal thereof, shall not become effective until approved by the Postal Regulatory Commission, and is subject to the cancellation authority of the Commission under section 3662(c).

“(b) Within 1 year after this subsection takes effect, the Postal Regulatory Commission shall adopt rules for the consideration of negotiated service agreements between the Postal Service and users of postal services, which meet the requirements of subsections (c) and (d).

“(c) Upon receipt of a proposed negotiated service agreement entered into by the Postal Service under subsection (a), or any amendment or renewal thereof, the Postal Regulatory Commission shall render a decision upon review of the agreement,

after notice and opportunity for comment by interested parties in accordance with section 553 of title 5, pursuant to the regulations adopted by the Commission under subsection (b). The Commission shall approve and recommend implementation of a proposed negotiated service agreement (or any amendment or renewal thereof) unless, on the basis of the written data, views, and arguments received, it finds, within 90 days after receipt of the proposed agreement, amendment, or renewal (subject to the same type of day-for-day extension as set forth in section 3733(b)(4)(B) for failure by the Postal Service to respond to any lawful order of the Commission), that—

“(1) the proposed agreement (or amendment or renewal, as applicable)—

“(A) does not satisfy the conditions and requirements of subsection (a);

“(B) precludes or materially hinders similarly situated mail users from entering into agreements with the Postal Service on the same, or substantially the same, terms and conditions; or

“(C) cannot reasonably be expected to result in net benefits to the operation of a nationwide postal system;

“(2) the Postal Service is unwilling or unable to enter into such negotiated service agreements with other similarly situated mail users; or

“(3) rates and fees payable during the term of the proposed negotiated service agreement are not reasonably calculated to yield to the Postal Service total revenues that equal or exceed the sum of—

“(A) the direct and indirect postal costs attributable to services performed by the Postal Service under the agreement; and

“(B) a portion of all other costs of the Postal Service that are equal, on an average unit basis, to the portion of such costs reasonably assignable to the classification or classifications of mail service most similar to the services performed under the agreement.

“(d) Whenever it disapproves a proposed negotiated service agreement, the Postal Regulatory Commission shall provide written notice to that effect, together with the reasons therefor.

“(e) Any decision to approve or disapprove a proposed negotiated service agreement (or amendment or renewal, as applicable) shall be subject to judicial review in accordance with section 3628(b).

“(f) Nothing in subsections (a) through (e) shall be considered to limit or otherwise affect any authority available to the Postal Service under section 3763.”

(2) CONFORMING AMENDMENT.—The table of sections at the beginning of chapter 36 of title 39, United States Code, is amended by striking the item relating to section 3641 and inserting the following:

“3641. Negotiated service agreements.”

(g) RATE AND SERVICE COMPLAINTS.—Section 3662 of title 39, United States Code, is amended to read as follows:

“§ 3662. Rate and service complaints

“(a) Interested parties (including an officer of the Postal Regulatory Commission representing the interests of the general public) who believe the Postal Service is charging rates which do not conform to the policies set out in this title, who believe that the Postal Service is not providing postal service in accordance with the policies of this title, or who believe that the Postal Service is otherwise not acting in conformance with the policies of this title, may lodge a complaint with the Postal Regulatory Commission in such form and in such manner as it may prescribe.

“(b)(1) The Postal Regulatory Commission shall, within 90 days after receiving a complaint under subsection (a), either—

“(A) begin proceedings on such complaint in conformity with section 3764(d)(1); or

“(B) issue an order dismissing the complaint (together with a statement of the reasons therefor).

“(2) For purposes of section 3628(b), any complaint under subsection (a) on which the Commission fails to act in the time and manner required by paragraph (1) shall be treated in the same way as if it had been dismissed pursuant to an order issued by the Commission on the last day allowable for the issuance of such order under paragraph (1).

“(c) If the Postal Regulatory Commission finds the complaint to be justified, it shall—

“(1) in a classification matter covered by section 3623 or 3762, after proceedings in conformity with section 3624, issue a recommended decision which shall be acted upon in accordance with the provisions of section 3625;

“(2) in a matter involving a violation of any limitation under section 3732 (relating to limitations on rates for noncompetitive products), order the unlawful rates to be adjusted to lawful levels and the taking of such other action as it deems appropriate;

“(3) in a matter involving a violation of section 3743(a) (relating to costs-attributable requirement for competitive products) or section 3763(b) (relating to conditions to be met by new competitive products), order the unlawful rates to be adjusted to lawful levels and the taking of such other action as it deems appropriate;

“(4) in a matter involving a violation of section 3641, order the payment of liquidated damages in accordance with the provisions included in the agreement involved pursuant to the requirements of section 3641(a)(3) or the cancellation of such agreement;

“(5) in a matter involving a violation of section 403(c), order the taking of such action as it deems appropriate;

“(6) in a matter involving a violation of any provision of subchapter V of chapter 37 (relating to market tests of experimental products), order the cancellation of the testing involved or the taking of such other action as it deems appropriate;

“(7) in a matter involving a violation of section 404a, order the rescission of any regulation involved or the taking of such action as it deems appropriate;

“(8) in a matter involving a violation of section 2012(f) (relating to the minimum amount to be charged by the Postal Service for goods or services provided to any corporation established under section 2012), order that the Postal Service increase its prices to at least the minimum levels required;

“(9) in a matter involving the Postal Service’s providing a nonpostal product that is not permitted under paragraph (6) of section 404(a), order that the Postal Service cease providing such product; and

“(10) in a matter not otherwise covered by any of the preceding provisions of this subsection, render a public report thereon.

“(d) In addition, in cases of deliberate noncompliance with the requirements of this title, the Postal Regulatory Commission may order, based on the nature, circumstances, extent, and seriousness of the noncompliance, a fine (in the amount specified by the Commission in its order) for each incidence of noncompliance. Fines resulting from the provision of competitive products (within the meaning of subchapter IV of chapter 37) shall be paid out of the Competitive Products Fund established in section 2011. All receipts from fines imposed under this subsection shall be deposited in the general fund of the Treasury of the United States.”.

(h) LIMITATIONS.—Section 3684 of title 39, United States Code, is amended—

(1) by inserting “and no provision of chapter 37” after “no provision of this chapter”; and

(2) by striking “any provision of section 3682 or 3683 or chapter 30, 32, or 34 of this title.” and inserting “any provision of this title.”.

(i) REDUCED RATES.—Effective as of the date of enactment of this Act, subclause (VI) of section 3626(a)(3)(B)(ii) of title 39, United States Code, is amended to read as follows:

“(VI) one-half (or less, as the Postal Service may prescribe), for any fiscal year after fiscal year 1998.”.

(j) REGULATIONS OF THE COMMISSION.—Effective as of the date of enactment of this Act, section 3603 of title 39, United States Code, is amended by striking “this chapter.” and inserting “this title.”.

(k) EFFECTIVE DATE.—Except as provided in subsection (i) or (j), this section and the amendments made by this section shall become effective on the date as of which the baseline rates are determined under section 3721(e)(2) of title 39, United States Code (as amended by section 201).

SEC. 203. POSTAL SERVICE COMPETITIVE PRODUCTS FUND.

(a) ESTABLISHMENT.—

(1) IN GENERAL.—Chapter 20 of title 39, United States Code, is amended by adding at the end the following:

“§ 2011. Postal Service Competitive Products Fund

“(a) There is established in the Treasury of the United States a revolving fund to be called the Postal Service Competitive Products Fund which shall be available to the Postal Service without fiscal-year limitation for the payment of all attributable costs, institutional costs, and other expenses incurred by the Postal Service in providing competitive products.

“(b) There shall be deposited in the Postal Service Competitive Products Fund, subject to withdrawal by the Postal Service—

“(1) revenues from competitive products;

“(2) amounts received from obligations issued by the Postal Service under this section;

“(3) interest which may be earned on investments of the Postal Service Competitive Products Fund; and

“(4) any amounts transferred from the Postal Service Fund under subsection (j).

“(c) The receipts and disbursements of the Postal Service Competitive Products Fund shall be accorded the same budgetary treatment as is accorded to receipts and disbursements of the Postal Service Fund under section 2009a.

“(d)(1) If the Postal Service determines that the moneys of the Postal Service Competitive Products Fund are in excess of current needs, it may invest such amounts as it deems advisable in any of the following:

“(A) A corporation established under section 2012.

“(B) Such other investments as it considers appropriate.

“(2)(A) Nothing in paragraph (1)(B) shall be considered to constitute authority for the Postal Service to invest in the obligations or securities of, or to make any other investment with respect to, a commercial entity.

“(B) For purposes of this paragraph, the term ‘commercial entity’ means any corporation, company, association, partnership, joint stock company, firm, society, or other similar entity, as further defined under regulations prescribed by the Postal Regulatory Commission.

“(e) The Postal Service, in its sole discretion, may provide that amounts which would otherwise be deposited in the Postal Service Competitive Products Fund shall instead be directly deposited in a Federal Reserve bank or a depository for public funds selected by the Postal Service, and may provide for transfers of amounts under this subsection between or among such accounts and the Postal Service Competitive Products Fund.

“(f) A judgment against the Postal Service or the Government of the United States arising out of activities of the Postal Service in the provision of competitive products (as determined under regulations which the Postal Regulatory Commission shall prescribe, in consultation with the Postal Service) shall be paid out of the Postal Service Competitive Products Fund.

“(g)(1) Subject to the limitations specified in section 2005(a) (applied in accordance with paragraph (2)), the Postal Service is authorized to borrow money and to issue and sell such obligations as it determines necessary to provide for competitive products and deposit such amounts in the Postal Service Competitive Products Fund, except that the Postal Service may pledge only the assets of the Postal Service Competitive Products Fund and pledge and use its revenues and receipts for the payment of the principal of or interest on such obligations, for the purchase or redemption thereof, and for other purposes incidental thereto, including creation of reserve, sinking, and other funds which may be similarly pledged and used, to such extent and in such manner as it deems necessary or desirable.

“(2) For purposes of applying any limitation under section 2005(a), the aggregate amount of obligations issued by the Postal Service which are outstanding at any given time, and the net increase in the amount of obligations outstanding issued by the Postal Service for the purpose of capital improvements or for the purpose of defraying operating expenses of the Postal Service in any fiscal year, shall be determined by aggregating all outstanding obligations so issued by the Postal Service under section 2005 with all outstanding obligations so issued by the Postal Service under this section.

“(h) The Postal Service may enter into binding covenants with the holders of such obligations, and with the trustee, if any, under any agreement entered into in connection with the issuance thereof with respect to the establishment of reserve, sinking, and other funds, application and use of revenues and receipts of the Postal Service Competitive Products Fund, stipulations concerning the subsequent issuance of obligations or the execution of leases or lease purchases relating to properties of the Postal Service and such other matters as the Postal Service deems necessary or desirable to enhance the marketability of such obligations.

“(i) Obligations issued by the Postal Service under this section shall—

“(1) not be purchased by the Secretary of the Treasury;

“(2) not be exempt either as to principal or interest from any taxation now or hereafter imposed by any State or local taxing authority;

“(3) not be obligations of, nor shall payment of the principal thereof or interest thereon be guaranteed by, the Government of the United States, and the obligations shall so plainly state; and

“(4) notwithstanding the provisions of the Federal Financing Bank Act of 1973 or any other provision of law (except as may be specifically provided by reference to this paragraph in any Act enacted after this paragraph takes effect), not be eligible for purchase by, or commitment to purchase by, or sale or issuance to, the Federal Financing Bank.

“(j) The Postal Service shall, on the first day of the first year beginning on or after the date as of which the baseline rates are determined under section 3721(e)(2), transfer from the Postal Service Fund to the Postal Service Competitive Products Fund an amount that, as determined by the Postal Regulatory Commission (after notice and opportunity for comment by interested parties in accordance with section 553 of title 5), fairly reflects the net value of assets and liabilities which may be attributed wholly or primarily to competitive products.

“(k) The Postal Service shall render an annual report to the Secretary of the Treasury concerning the operation of the Postal Service Competitive Products Fund, in which it shall address such matters as risk limitations, reserve balances, allocation or distribution of moneys, liquidity requirements, and measures to safeguard against losses. A copy of its then most recent report under this subsection shall be included together with any other submission that it is required to make to the Postal Regulatory Commission under section 3772(g).

“(l) For purposes of this section, the term ‘competitive product’ has the meaning given such term by section 3701.”

(2) CLERICAL AMENDMENT.—The table of sections at the beginning of chapter 20 of title 39, United States Code, is amended by adding after the item relating to section 2010 the following:

“2011. Postal Service Competitive Products Fund.”

(b) TECHNICAL AND CONFORMING AMENDMENTS.—

(1) CAPITAL OF THE POSTAL SERVICE.—Section 2002(b) of title 39, United States Code, is amended by striking “Fund,” and inserting “Fund and the balance in the Postal Service Competitive Products Fund.”

(2) POSTAL SERVICE FUND.—

(A) PURPOSES FOR WHICH AVAILABLE.—

(i) IN GENERAL.—Section 2003(a) of title 39, United States Code, is amended by striking “title.” and inserting “title (other than any of the purposes, functions, or powers for which the Postal Service Competitive Products Fund is available).”

(ii) CONFORMING AMENDMENT.—Section 2003(e)(1) of title 39, United States Code, is amended by inserting after “as provided by law” the following: “(subject to the same limitation as set forth in the parenthetical matter under subsection (a))”

(B) DEPOSITS.—Section 2003(b) of title 39, United States Code, is amended by striking “There” and inserting “Except as otherwise provided in section 2011, there”.

(3) INVESTMENTS.—Subsection (c) of section 2003 of title 39, United States Code, is amended—

(A) by striking “(c) If” and inserting “(c)(1) Except as provided in paragraph (2), if”; and

(B) by adding at the end the following:

“(2) Nothing in this subsection shall be considered to authorize any investment in any obligations or securities of a commercial entity (as defined by section 2011(d)(2)(B)), including any corporation established under section 2012.”

(4) OBLIGATIONS.—

(A) PURPOSES FOR WHICH ISSUANCE IS ALLOWED.—The first sentence of section 2005(a)(1) of title 39, United States Code, is amended by striking “title.” and inserting “title (other than any of the purposes for which the corresponding authority is available to the Postal Service under section 2011).”

(B) SPECIAL RULE FOR APPLYING LIMITATIONS.—Paragraph (1) of section 2005(a) of title 39, United States Code, is amended by adding at the end the following: “The limitations under the second and third sentences of this subsection shall be applied in accordance with section 2011(g)(2).”

(5) RELATIONSHIP BETWEEN THE TREASURY AND THE POSTAL SERVICE.—Section 2006(c) of title 39, United States Code, is amended by inserting “under section 2005” before “shall be obligations”.

SEC. 204. USPS CORPORATION.

(a) ESTABLISHMENT.—Chapter 20 of title 39, United States Code, is amended by adding after section 2011 (as added by section 203) the following:

“§ 2012. USPS Corporation

“(a) The Board of Directors may establish a private for-profit corporation under the laws of a State to be known as the USPS Corporation or such other corporate name as may be duly adopted by the Corporation. The Board of Directors may serve as incorporators of the Corporation and take all steps necessary to establish the Corporation, including the filing of articles of incorporation consistent with the provisions of this section.

“(b)(1) The Corporation shall not be an agency, instrumentality, or establishment of the United States, a Government corporation, or a Government-controlled corporation. Except as provided in this section, the Corporation shall not be considered part of the Postal Service. Financial obligations of the Corporation shall not be obligations of, or guaranteed as to principal or interest by, the Postal Service or the United States, and the obligations shall so plainly state. No action shall be allowable against the United States based on actions of the Corporation.

“(2) The receipts and disbursements of the Corporation shall be accorded the same budgetary treatment as is accorded to receipts and disbursements of the Postal Service Fund under section 2009a.

“(c) The Corporation is authorized to issue and have outstanding, in such amounts as it shall determine, shares of capital stock, without par value, which shall carry voting rights and be eligible for dividends. Such shares may be purchased only by the Postal Service Competitive Products Fund, in such amounts as the Board of Directors of the Postal Service may deem appropriate.

“(d) Notwithstanding any provision of State law, the articles of incorporation and bylaws of the Corporation shall provide that its board of directors shall be named by the Board of Directors of the Postal Service. The restrictions on postgovernment employment set out in section 207 of title 18 shall not apply to the acts of an individual taken in carrying out official duties as a director, officer, or employee of the Corporation if the individual was an officer or employee of the Postal Service (including a Director) continuously for a period of 12 months or longer during the 24 months prior to employment with the Corporation.

“(e) The Corporation shall have all of the powers conferred upon it under the laws of the State or States in which it is incorporated. The Corporation is specifically authorized—

“(1) to offer any postal or nonpostal product (other than a product covered by the postal monopoly, as defined in section 3764(b)(2));

“(2) acquire shares of individual private companies; and

“(3) participate in joint ventures with individual private companies.

“(f) The Corporation may purchase goods and services from the Postal Service, except that the Corporation must pay the Postal Service the same amount for such goods or services as would be paid by similarly situated mailers or, if the goods or services are not offered to the public by the Postal Service, amounts which represent fair market value.

“(g)(1) Insofar as the Corporation offers postal products which depend in substantial part on the services of the Postal Service, the Postal Service shall, to the extent deemed appropriate by the Postal Regulatory Commission (and subject to such requirements as the Commission may specify as to form and content), include details of the activities of the Corporation (including sufficient information to demonstrate that the requirements of subsection (f) are being complied with) in the annual reports to the Commission required by section 3772.

“(2) In the event that, based on its review of the information submitted to it by the Postal Service under paragraph (1), the Commission determines that the requirements of subsection (f) are not being complied with, the Commission may issue any order allowable under subsection (c)(8) or (d) of section 3662.

“(h) As used in this section, the term ‘State’ includes the District of Columbia.”

(b) CLERICAL AMENDMENT.—The table of sections at the beginning of chapter 20 of title 39, United States Code, is amended by adding after the item relating to section 2011 (as added by section 203) the following:

“2012. USPS Corporation.”

(c) EFFECTIVE DATE.—No authority under section 2012 of title 39, United States Code (as amended by this section) shall be available until the first day of the first year beginning on or after the date as of which the baseline rates are determined under section 3721(e)(2).

SEC. 205. POSTAL AND NONPOSTAL PRODUCTS.

(a) IN GENERAL.—Section 102 of title 39, United States Code, as amended by section 102(a) of this Act, is amended by striking “and” at the end of paragraph (4),

by striking the period at the end of paragraph (5) and inserting a semicolon, and by adding at the end the following:

“(6) ‘postal product’ refers to any service that provides for the physical delivery of letters, printed matter, or packages weighing up to 70 pounds, including physical acceptance, collection, sorting, or transportation services ancillary thereto; and

“(7) ‘nonpostal product’ means any product or service offered by the Postal Service (or that could have been offered by the Postal Service under section 404(a)(6), as last in effect before the date of enactment of the Postal Modernization Act of 1999) that is not a postal product.”.

(b) SPECIFIC POWERS.—

(1) IN GENERAL.—Paragraph (6) of section 404(a) of title 39, United States Code, is amended to read as follows:

“(6)(A) to continue providing or to abolish any nonpostal product first offered by the Postal Service to the general public before January 1, 1994 (with any nonpostal products not offered by the Postal Service to the general public before January 1, 1994, to be provided by means of a private corporation organized under section 2012, if at all, instead of the Postal Service); and

“(B) with respect to any nonpostal products first offered by the Postal Service to the general public during the period beginning on January 1, 1994, and ending on the date of enactment of the Postal Modernization Act of 1999, to continue to offer such products, but only—

“(i) subject to clause (ii), until such products are transferred to the private postal corporation (referred to in subparagraph (A)) in accordance with such schedule and procedures as the Postal Regulatory Commission shall by regulation prescribe; or

“(ii) until the first day of the first year of the first ratemaking cycle (within the meaning of section 3733(a)), if the transfer described in clause (i) has not been completed by such date.”.

(2) DEADLINE.—The regulations required under section 404(a)(6)(B) of title 39, United States Code, as amended by this subsection, shall be prescribed in time to become effective by the commencement of the first proceedings under section 3733 of title 39, United States Code (relating to adjustment factors), as added by section 201.

Subtitle B—Related Provisions

SEC. 211. AUTHORITY FOR POSTAL REGULATORY COMMISSION TO ISSUE SUBPOENAS.

Section 3604 of title 39, United States Code, is amended by adding at the end the following:

“(f)(1) Any Commissioner of the Postal Regulatory Commission, any administrative law judge appointed by the Commission under section 3105 of title 5, and any employee of the Commission designated by the Commission may administer oaths, examine witnesses, take depositions, and receive evidence.

“(2) The Chairman of the Commission, any Commissioner designated by the Chairman, and any administrative law judge appointed by the Commission under section 3105 of title 5 may, with respect to any proceeding conducted by the Commission under this title—

“(A) issue subpoenas requiring the attendance and presentation of testimony of any individual, and the production of documentary or other evidence, from any place in the United States, any territory or possession of the United States, the Commonwealth of Puerto Rico, or the District of Columbia; and

“(B) order the taking of depositions and responses to written interrogatories.

The written concurrence of a majority of the Commissioners then holding office shall, with respect to each subpoena under subparagraph (A), be required in advance of its issuance.

“(3) In the case of contumacy or failure to obey a subpoena issued under this subsection, upon application by the Commission, the district court of the United States for the district in which the person to whom the subpoena is addressed resides or is served may issue an order requiring such person to appear at any designated place to testify or produce documentary or other evidence. Any failure to obey the order of the court may be punished by the court as a contempt thereof.

“(g)(1) If the Postal Service determines that any document or other matter it provides to the Postal Regulatory Commission pursuant to a subpoena issued under subsection (f), or otherwise at the request of the Commission in connection with any proceeding or other purpose under this chapter or chapter 37, contains information which is described in section 410(c) of this title, or exempt from public disclosure

under section 552(b) of title 5, the Postal Service shall, at the time of providing such matter to the Commission, notify the Commission, in writing, of its determination (and the reasons therefor).

“(2) No officer or employee of the Commission may, with respect to any information as to which the Commission has been notified under paragraph (1)—

“(A) use such information for purposes other than the purposes for which it is supplied; or

“(B) permit anyone who is not an officer or employee of the Commission to have access to any such information.

“(3) Paragraph (2) shall not prevent information from being furnished under any process of discovery established under this title in connection with a proceeding under this chapter or chapter 37 which is conducted in accordance with sections 556 and 557 of title 5. The Commission shall, by regulations based on rule 26(c) of the Federal Rules of Civil Procedure, establish procedures for ensuring appropriate confidentiality for any information furnished under the preceding sentence.”.

SEC. 212. QUALIFICATION REQUIREMENTS FOR COMMISSIONERS AND DIRECTORS.

(a) COMMISSIONERS.—Section 3601(a) of title 39, United States Code, is amended by striking the third sentence and inserting the following: “The Commissioners shall be chosen solely on the basis of their technical qualifications, professional standing, and demonstrated expertise in economics, accounting, law, or public administration, and may be removed by the President only for cause.”.

(b) DIRECTORS.—

(1) IN GENERAL.—Section 202(a) of title 39, United States Code, is amended by striking “(a)” and inserting “(a)(1)” and by striking the fourth sentence and inserting the following: “The Directors shall represent the public interest generally, and shall be chosen solely on the basis of their demonstrated ability in managing organizations or corporations, in either the public or the private sector, similar in size or scope to the Postal Service. The Directors shall not be representatives of specific interests using the Postal Service, and may be removed only for cause.”.

(2) CONSULTATION REQUIREMENT.—Subsection (a) of section 202 of title 39, United States Code, is amended by adding at the end the following:

“(2) In selecting the individuals described in paragraph (1) for nomination for appointment to the position of Director, the President should consult with the Speaker of the House of Representatives, the minority leader of the House of Representatives, the majority leader of the Senate, and the minority leader of the Senate.”.

(3) RESTRICTION.—Subsection (b) of section 202 of title 39, United States Code, is amended by striking “(b)” and inserting “(b)(1)”, and by adding at the end the following:

“(2)(A) Notwithstanding any other provision of this section, in the case of the office of the Director the term of which is the first one scheduled to expire at least 4 months after the date of enactment of this paragraph—

“(i) such office may not, in the case of any person commencing service after that expiration date, be filled by any person other than an individual chosen from among persons nominated for such office with the unanimous concurrence of all labor organizations described in section 206(a)(1); and

“(ii) instead of the term that would otherwise apply under the first sentence of paragraph (1), the term of any person so appointed to such office shall be 3 years.

“(B) Except as provided in subparagraph (A), an appointment under this paragraph shall be made in conformance with all provisions of this section that would otherwise apply.”.

(c) APPLICABILITY.—Nothing in this section shall affect the tenure of any individual serving as a Commissioner on the Postal Regulatory Commission or a Director of the Board of Directors of the United States Postal Service pursuant to an appointment made before the date of enactment of this Act, or, except as provided in the amendment made by subsection (b)(3), any nomination made before such date of enactment.

SEC. 213. APPROPRIATIONS FOR THE COMMISSION.

(a) AUTHORIZATION OF APPROPRIATIONS.—Subsection (d) of section 3604 of title 39, United States Code, is amended to read as follows:

“(d) There are authorized to be appropriated, out of the Postal Service Fund, such sums as may be necessary for the Postal Regulatory Commission. In requesting an appropriation under this subsection for a fiscal year, the Commission shall prepare and submit to the Congress under section 2009 a budget of the Commission’s

expenses, including expenses for facilities, supplies, compensation, and employee benefits.”.

(b) BUDGET PROGRAM.—

(1) IN GENERAL.—The next to last sentence of section 2009 of title 39, United States Code, is amended to read as follows: “The budget program shall also include separate statements of the amounts which (1) the Postal Service requests to be appropriated under subsections (b) and (c) of section 2401, (2) the Office of Inspector General of the United States Postal Service requests to be appropriated, out of the Postal Service Fund, under section 8G(f) of the Inspector General Act of 1978, and (3) the Postal Regulatory Commission requests to be appropriated, out of the Postal Service Fund, under section 3604(d) of this title.”.

(2) CONFORMING AMENDMENT.—Section 2003(e)(1) of title 39, United States Code, is amended by striking the matter before the second sentence and inserting the following:

“(e)(1) The Fund shall be available for the payment of all expenses incurred by the Postal Service in carrying out its functions as provided by law and—

“(A) subject to the availability of amounts appropriated pursuant to section 3604(d), all of the expenses of the Postal Regulatory Commission; and

“(B) subject to the availability of amounts appropriated pursuant to section 8G(f) of the Inspector General Act of 1978, all of the expenses of the Office of Inspector General.”.

(c) EFFECTIVE DATE.—

(1) IN GENERAL.—The amendments made by this section shall apply with respect to fiscal years beginning on or after October 1, 1999.

(2) SAVINGS PROVISION.—The provisions of title 39, United States Code, that are amended by this section shall, for purposes of any fiscal year before the first fiscal year to which the amendments made by this section apply, continue to apply in the same way as if this section had never been enacted.

SEC. 214. CHANGE-OF-ADDRESS ORDER INVOLVING A COMMERCIAL MAIL RECEIVING AGENCY.

(a) IN GENERAL.—Subchapter V of chapter 36 of title 39, United States Code, is amended by adding at the end the following:

“§ 3686. Change-of-address order involving a commercial mail receiving agency

“(a) For the purpose of this section, the term ‘commercial mail receiving agency’ or ‘CMRA’ means a private business that acts as the mail receiving agent for specific clients.

“(b) Upon termination of an agency relationship between an addressee and a commercial mail receiving agency—

“(1) the addressee or, if authorized to do so, the CMRA may file a change-of-address order with the Postal Service with respect to such addressee;

“(2) a change-of-address order so filed shall, to the extent practicable, be given full force and effect; and

“(3) any mail for the addressee that is delivered to the CMRA after the filing of an appropriate order under this subsection shall be subject to subsection (c).

“(c) Mail described in subsection (b)(3) shall, if marked for forwarding and re-mailed by the CMRA, be forwarded by the Postal Service in the same manner as, and subject to the same terms and conditions (including limitations on the period of time for which a change-of-address order shall be given effect) as apply to, mail forwarded directly by the Postal Service to the addressee.”.

(b) CLERICAL AMENDMENT.—The table of sections at the beginning of chapter 36 of title 39, United States Code, is amended by adding after the item relating to section 3685 the following:

“3686. Change-of-address order involving a commercial mail receiving agency.”.

SEC. 215. RATES FOR MAIL UNDER FORMER SECTION 4358.

Section 3626 of title 39, United States Code, is amended by adding at the end the following:

“(n) In the administration of this section, matter that satisfies the circulation standards for requester publications shall not be excluded from being mailed at the rates for mail under former section 4358 solely because such matter is designed primarily for free circulation or for circulation at nominal rates, or fails to meet the requirements of former section 4354(a)(5).”.

TITLE III—GENERAL AUTHORITY

SEC. 301. RULEMAKING AUTHORITY.

Paragraph (2) of section 401 of title 39, United States Code, is amended to read as follows:

“(2) to adopt, amend, and repeal such rules and regulations, not inconsistent with this title, as may be necessary in the execution of its functions under this title;”.

SEC. 302. GENERAL DUTIES.

Section 403(c) of title 39, United States Code, is amended—

- (1) by inserting “domestic or international” after “users of the”; and
- (2) by striking “user.” and inserting “user, except that this subsection shall not apply to competitive products (as defined in chapter 37).”.

SEC. 303. EMPLOYMENT OF POSTAL POLICE OFFICERS.

Section 404 of title 39, United States Code, is amended by adding at the end the following:

“(c)(1) The Postal Service may employ guards for all buildings and areas owned or occupied by the Postal Service or under the charge and control of the Postal Service, and such guards shall have, with respect to such property, the powers of special policemen provided by the first section of the Act cited in paragraph (2), and, as to such property, the Postmaster General (or his designee) may take any action that the Administrator of General Services (or his designee) may take under section 2 or 3 of such Act, attaching thereto penalties under the authority and within the limits provided in section 4 of such Act.

“(2) The Act cited in this paragraph is the Act of June 1, 1948 (62 Stat. 281), commonly known as the Protection of Public Property Act.”.

SEC. 304. DATE OF POSTMARK TO BE TREATED AS DATE OF APPEAL IN CONNECTION WITH THE CLOSING OR CONSOLIDATION OF POST OFFICES.

(a) IN GENERAL.—Section 404(b) of title 39, United States Code, is amended by adding at the end the following:

“(6) For purposes of paragraph (5), any appeal received by the Commission shall—

“(A) if sent to the Commission through the mails, be considered to have been received on the date of the Postal Service postmark on the envelope or other cover in which such appeal is mailed; or

“(B) if otherwise lawfully delivered to the Commission, be considered to have been received on the date determined based on any appropriate documentation or other indicia (as determined under regulations of the Commission).”.

(b) EFFECTIVE DATE.—This section and the amendments made by this section shall apply with respect to any determination to close or consolidate a post office which is first made available, in accordance with paragraph (3) of section 404(b) of title 39, United States Code, after the end of the 3-month period beginning on the date of enactment of this Act.

SEC. 305. UNFAIR COMPETITION PROHIBITED.

(a) SPECIFIC LIMITATIONS.—Chapter 4 of title 39, United States Code, is amended by adding after section 404 the following:

“§ 404a. Specific limitations

“(a) In providing products and services and in establishing classifications, rates, and fees under this title, the Postal Service, any corporation established under section 2012, and any other entity funded, in whole or in part, by the Postal Service, shall not, directly or indirectly, except as specifically authorized by law—

“(1) provide any postal or nonpostal product or service, with respect to which the Postal Service or any such corporation or entity (as the case may be), precludes competition or otherwise establishes the terms of competition through regulation (including standard-setting), licensing, or policy-setting;

“(2)(A) establish any regulation (including any standard) the effect of which is (or would be) to create a monopoly or any competitive advantage for itself, any such corporation or entity, or any other person; or

“(B) enter into any agreement, establish any policy, or take any other action (not covered by subparagraph (A)), the effect of which is (or would be) to create a monopoly or any other unlawful competitive advantage for itself, any such corporation or entity, or any other person;

“(3) regulate competition or engage in any regulatory or enforcement activity with respect to actions or practices that are subject to the antitrust laws;

"(4) obtain information from a person that provides, or seeks to provide, a postal or nonpostal product or service, and subsequently disclose that information, or offer any product or service that uses or is based in whole or in part on that information, without the consent of the person providing that information, unless substantially the same information is obtained from an independent source or is otherwise obtained by the Postal Service, corporation, or other entity (as the case may be) in a manner not inconsistent with this paragraph; or

"(5) compel the disclosure, transfer, or licensing of intellectual property (such as patents, copyrights, trademarks, trade secrets, and proprietary information).

"(b)(1) For purposes of this section, the term 'antitrust laws' has the meaning given such term in subsection (a) of the first section of the Clayton Act (15 U.S.C. 12(a)), but includes section 5 of the Federal Trade Commission Act (15 U.S.C. 45) to the extent that such section 5 applies to unfair methods of competition.

"(2) Nothing in this section shall be construed as limiting the scope or effect of intellectual property rights recognized under the laws of the United States.

"(c) The Postal Regulatory Commission shall prescribe regulations to carry out the purposes of this section."

(b) CLERICAL AMENDMENT.—The table of sections at the beginning of chapter 4 of title 39, United States Code, is amended by adding at the end the following:

"404a. Specific limitations."

SEC. 306. INTERNATIONAL POSTAL ARRANGEMENTS.

(a) INTERNATIONAL POSTAL ARRANGEMENTS.—

(1) IN GENERAL.—Section 407 of title 39, United States Code, is amended to read as follows:

"§ 407. International postal arrangements

"(a) It is the policy of the United States—

"(1) to promote and encourage communications between peoples by efficient operation of international postal services and other international delivery services for cultural, social, and economic purposes;

"(2) to promote and encourage unrestricted and undistorted competition in the provision of international postal services and other international delivery services, except where provision of such services by private companies may be prohibited by law of the United States;

"(3) to promote and encourage a clear distinction between governmental and operational responsibilities with respect to the provision of international postal services and other international delivery services by the Government of the United States and by intergovernmental organizations of which the United States is a member; and

"(4) to participate in multilateral and bilateral agreements with other countries to accomplish these objectives.

"(b)(1) The Secretary of State shall be responsible for formulation, coordination, and oversight of foreign policy related to international postal services and other international delivery services, except that the Secretary may not negotiate or conclude any treaty, convention, or other international agreement (including those regulating international postal services) if such treaty, convention, or agreement would, with respect to any competitive product (as that term is defined in chapter 37), grant an undue or unreasonable preference to the Postal Service, a private provider of international postal or delivery services, or any other person.

"(2) In carrying out the responsibilities specified in paragraph (1), the Secretary of State shall—

"(A) exercise primary authority for the conduct of foreign policy with respect to international postal services and international delivery services, including the determination of United States positions and the conduct of United States participation in negotiations with foreign governments and international bodies; in exercising this responsibility, the Secretary shall coordinate with other agencies as appropriate, and in particular, shall give full consideration to the authority vested by law or Executive order in the Postal Regulatory Commission, the Department of Commerce, the Department of Transportation, and the Office of the United States Trade Representative in this area;

"(B) maintain continuing liaison with other executive branch agencies concerned with postal and delivery services;

"(C) maintain continuing liaison with the Committee on Government Reform and Oversight of the House of Representatives and the Committee on Governmental Affairs of the Senate;

“(D) maintain appropriate liaison with representatives of the Postal Service to keep informed of its interests and problems, and to provide such assistance as may be needed to ensure that matters of concern to the Postal Service are promptly considered by the Department of State or (if applicable, and to the extent practicable) other executive branch agencies;

“(E) maintain appropriate liaison with representatives of users and private providers of international postal services and other international delivery services to keep informed of their interests and problems, and to provide such assistance as may be needed to ensure that matters of concern are promptly considered by the Department of State or (if applicable, and to the extent practicable) other executive branch agencies; and

“(F) assist in arranging meetings of such public sector advisory groups as may be established to advise the Department of State and other executive branch agencies in connection with international postal services and international delivery services.

“(c) Nothing in this section shall be considered to prevent the Postal Service from entering into such commercial or operational contracts related to providing international postal services and other international delivery services as it deems appropriate, except that—

“(1) any such contract made with an agency of a foreign government (whether under authority of this subsection or otherwise) must be solely contractual in nature and may not purport to be international law; and

“(2) a copy of each such contract between the Postal Service and an agency of a foreign government shall be transmitted to the Secretary of State and the Postal Regulatory Commission not later than the effective date of such contract.

“(d)(1) With respect to shipments of international mail within the meaning of section 3741 that are exported or imported by the Postal Service—

“(A) the Postal Service shall not tender exported shipments to governmental authorities of any other country for clearance and importation except in accordance with procedures and laws which are equally applicable to similar shipments transmitted by private companies; and

“(B)(i) subject to clause (ii), the Customs Service and other appropriate Federal agencies shall apply the customs laws of the United States and all other laws relating to the importation or exportation of such shipments in the same manner to both shipments by the Postal Service and similar shipments by private companies; and

“(ii) the Customs Service and other Federal agencies shall deny shipments imported by the Postal Service from a foreign country access to special customs procedures established in accordance with international postal or customs agreements for shipments by postal authorities of other countries unless that foreign country makes available such special customs procedures both to shipments to such country from the United States by the Postal Service and similar shipments to such country from the United States by private companies.

“(2)(A) The provisions of paragraph (1)(B)(i) shall take effect beginning on the date of enactment of this subsection.

“(B) The provisions of subparagraphs (A) and (B)(ii) of paragraph (1) shall take effect beginning 5 years after the date of enactment of this subsection.

“(C) The Secretary of State shall, to the maximum extent practicable, take such measures as are within the control of the Secretary—

“(i) to complete the renegotiation of any treaties, conventions, or other international agreements (including those regulating international postal services), and

“(ii) to encourage the governments of other countries to make any changes in their laws (consistent with the policies carried out by the provisions referred to in subparagraph (B)),

which may be necessary in order to facilitate the timely implementation of the provisions that are subject to subparagraph (B). The Secretary of State shall consult with the United States Trade Representative and the Commissioner of Customs in carrying out this subparagraph.

“(3) For purposes of this subsection, the term ‘private company’ means a private company substantially owned or controlled by persons who are citizens of the United States.”.

(2) EFFECTIVE DATE.—Notwithstanding paragraph (1), the authority of the United States Postal Service to establish the rates of postage or other charges on mail matter conveyed between the United States and other countries shall remain available to the Postal Service until the date as of which the baseline rates are determined under section 3721(e)(2) of title 39, United States Code (as amended by section 201).

(b) TRADE-IN-SERVICES PROGRAM.—The second sentence of paragraph (5) of section 306(a) of the Trade and Tariff Act of 1984 (19 U.S.C. 2114b(5)) is amended by inserting "postal and delivery services," after "transportation,".

SEC. 307. SUITS BY AND AGAINST THE POSTAL SERVICE.

(a) IN GENERAL.—Section 409 of title 39, United States Code, is amended by striking subsections (c) through (e) and inserting the following:

"(c) For purposes of the Act of July 5, 1946 (commonly referred to as the 'Trademark Act of 1946' (15 U.S.C. 1051 and following)), the Postal Service shall be considered to be a 'person', as used in that Act, and shall not be immune under any other doctrine of sovereign immunity from suit in Federal court by any person for any violation of that Act by any officer or employee of the Postal Service.

"(d)(1) To the extent that the Postal Service, or other Federal agency acting on behalf of or in concert with the Postal Service, engages in conduct with respect to any service which is not reserved to the United States under section 1696 of title 18, the Postal Service or other Federal agency—

"(A) shall not be immune under any doctrine of sovereign immunity from suit in Federal court by any person for any violation of law by such agency or any officer or employee thereof;

"(B) shall not be considered a 'Federal agency' for purposes of section 1346(b) and chapter 171 of title 28, and shall be liable for actions in tort in the same manner as a private company; and

"(C) shall be considered to be a person (as defined in subsection (a) of the first section of the Clayton Act (15 U.S.C. 12(a)) for purposes of—

"(i) the antitrust laws (as defined in subsection (a) of the first section of the Clayton Act (15 U.S.C. 12(a)); and

"(ii) section 5 of the Federal Trade Commission Act (15 U.S.C. 45) to the extent that such section 5 applies to unfair methods of competition.

For purposes of the preceding sentence, any private carriage of mail allowable by virtue of section 601 shall not be considered a service reserved to the United States under section 1696 of title 18.

"(2) This subsection shall not apply with respect to conduct occurring before the date of enactment of this subsection.

"(e)(1) Motor vehicles owned or leased by the Postal Service that are primarily and regularly used for the transport or delivery of products in the competitive category of mail shall be subject to Federal and State laws and regulations associated with the parking and operation of such motor vehicles, to the same extent and in the same manner as if they were owned or leased by a private company.

"(2) Any motor vehicle owned or leased by the Postal Service that is primarily and regularly used for the transport or delivery of products in the competitive category of mail shall be clearly identified as such by appropriate symbol or other marking.

"(3) This subsection shall become effective on the first day of the first rate-making cycle.

"(4) For purposes of this subsection—

"(A) the terms 'product in the competitive category of mail' and 'ratemaking cycle' have the meanings given them by chapter 37; and

"(B) the term 'State' includes the District of Columbia, the Commonwealth of Puerto Rico, and a territory or possession of the United States.

"(f)(1) The Postal Service shall comply with—

"(A) any zoning, planning, and land use regulations applicable to State or local public entities; and

"(B) any building codes applicable to State or local public entities.

"(2) For purposes of this subsection, the term 'State' has the meaning given such term by subsection (e).

"(g)(1) The Postal Service shall employ attorneys by contract or otherwise to conduct litigation on its behalf in any litigation arising, in whole or in part, under any of the following:

"(A) Subsection (c), (d), or (e) of section 409 (relating to application of certain laws to the Postal Service).

"(B) Subsection (f) or (g) of section 3604 (relating to administrative subpoenas by the Postal Regulatory Commission).

"(C) Subsection (a) or (b) of section 3628 (relating to appeals from decisions of the Commission and the Directors).

"(2) In any circumstance not covered by paragraph (1), the Department of Justice shall, under section 411, furnish the Postal Service such legal representation as it may require, except that, with the prior consent of the Attorney General, the Postal Service may, in any such circumstance, employ attorneys by contract or oth-

erwise to conduct litigation brought by or against the Postal Service or its officers or employees in matters affecting the Postal Service.

“(h) A judgment against the Government of the United States arising out of activities of the Postal Service shall be paid by the Postal Service out of any funds available to the Postal Service, subject to the restriction specified in section 2011(f).”

(b) **TECHNICAL AMENDMENT.**—Section 409(a) of title 39, United States Code, is amended by striking “Except as provided in section 3628 of this title,” and inserting “Except as otherwise provided in this title.”

TITLE IV—MISCELLANEOUS PROVISIONS RELATING TO THE BUDGET AND APPROPRIATIONS PROCESS

SEC. 401. PROVISIONS RELATING TO BENEFITS UNDER CHAPTER 81 OF TITLE 5, UNITED STATES CODE, FOR OFFICERS AND EMPLOYEES OF THE FORMER POST OFFICE DEPARTMENT.

(a) **IN GENERAL.**—Section 8 of the Postal Reorganization Act (39 U.S.C. 1001 note) is amended by inserting “(a)” after “8.” and by adding at the end the following:

“(b) For purposes of chapter 81 of title 5, United States Code, the Postal Service shall, with respect to any individual receiving benefits under such chapter as an officer or employee of the former Post Office Department, have the same authorities and responsibilities as it has with respect to an officer or employee of the Postal Service receiving such benefits.”

(b) **EFFECTIVE DATE.**—This section and the amendments made by this section shall take effect on October 1, 1998.

SEC. 402. TECHNICAL AND CONFORMING AMENDMENTS.

(a) **APPROPRIATIONS.**—Subsection (e) of section 2401 of title 39, United States Code, is amended—

(1) by striking “Committee on Post Office and Civil Service” each place it appears and inserting “Committee on Government Reform and Oversight”;

(2) by striking “and the Committees on Appropriations of the Senate and the House of Representatives”; and

(3) by striking “Not later than March 15 of each year,” and inserting “Each year.”

(b) **TECHNICAL CORRECTION.**—Sections 2803(a) and 2804(a) of title 39, United States Code, are amended by striking “2401(g)” and inserting “2401(e)”.

TITLE V—PROVISIONS RELATING TO TRANSPORTATION, CARRIAGE, OR DELIVERY OF MAIL

SEC. 501. OBSOLETE PROVISIONS.

(a) **REPEAL.**—Chapter 52 of title 39, United States Code, is repealed.

(b) **CONFORMING AMENDMENTS.**—Section 5005(a) of title 39, United States Code, is amended—

(1) by repealing paragraph (1); and

(2) in paragraph (4) by striking “(as defined in section 5201(6) of this title)”.

(c) **ELIMINATING RESTRICTION ON LENGTH OF CONTRACTS.**—(1) Section 5005(b)(1) of title 39, United States Code, is amended by striking “(or where the Postal Service determines that special conditions or the use of special equipment warrants, not in excess of 6 years)” and inserting “(or such length of time as may be determined by the Postal Service to be advisable or appropriate)”.

(2) Section 5402(c) of such title 39 is amended by striking “for a period of not more than 4 years”.

(3) Section 5605 of such title 39 is amended by striking “for periods of not in excess of 4 years”.

(d) **CLERICAL AMENDMENT.**—The table of chapters for part V of title 39, United States Code, is amended by repealing the item relating to chapter 52.

SEC. 502. EXPANDED CONTRACTING AUTHORITY.

Subsection (d) of section 5402 of title 39, United States Code, is amended to read as follows:

“(d) Notwithstanding the provisions of subsections (a) through (c), the Postal Service may contract for the transportation of mail by aircraft, except as provided in subsections (f) and (g).”

SEC. 503. PRIVATE CARRIAGE OF LETTERS.

(a) **REPEAL OF SUSPENSION AUTHORITY.**—Subsection (b) of section 601 of title 39, United States Code, is repealed.

(b) PRIVATE CARRIAGE.—Section 601 of title 39, United States Code, is amended by striking subsection (a) and inserting the following:

“(a) A letter may be carried out of the mails when—

“(1) the amount paid for the private carriage of the letter is at least the amount equal to 6 times the rate then currently charged for the 1st ounce of a single-piece first-class letter;

“(2) the letter weighs at least 12 ½ ounces;

“(3) such carriage is within the scope of services described by regulations of the United States Postal Service (as in effect on July 1, 1998) that purport to permit private carriage by suspension of the operation of this subsection (as then in effect); or

“(4) the requirements of subsection (b) are met.

“(b) A letter shall be considered to satisfy the requirements of this subsection if—

“(1) it is enclosed in an envelope;

“(2) the amount of postage which would have been charged on the letter if it had been sent by mail is paid by stamps, or postage meter stamps, on the envelope;

“(3) the envelope is properly addressed;

“(4) the envelope is so sealed that the letter cannot be taken from it without defacing the envelope;

“(5) any stamps on the envelope are canceled in ink by the sender; and

“(6) the date of the letter, of its transmission or receipt by the carrier is endorsed on the envelope in ink.”

(c) EFFECTIVE DATE.—This section shall take effect as of the first day of the first year beginning on or after the date as of which the baseline rates are determined under section 3721(e)(2).

SEC. 504. REPEAL OF SECTION 5403.

(a) IN GENERAL.—Section 5403 of title 39, United States Code, is repealed.

(b) CLERICAL AMENDMENT.—The table of sections for chapter 54 of title 39, United States Code, is amended by repealing the item relating to section 5403.

TITLE VI—STUDIES

SEC. 601. EMPLOYEE-MANAGEMENT RELATIONS.

(a) INDEPENDENT STUDY REQUIRED.—The Board of Directors shall, by contract, provide for the National Academy of Public Administration to conduct an independent study as to how employee-management relations within the United States Postal Service may be improved.

(b) SPECIFIC REQUIREMENTS.—Under the contract, the Academy shall be required—

(1) to involve the labor, supervisory, and managerial organizations of the Postal Service in developing the design and specific objectives of the study;

(2) to consult periodically with representatives of the Postal Service, and of those labor, supervisory, and managerial organizations, on the progress of the study; and

(3) to provide opportunity for those labor, supervisory, and managerial organizations to review and submit written comments on the final report.

(c) FINAL REPORT.—

(1) IN GENERAL.—The Academy shall, not later than 12 months after the date on which the contract for the study under this section is entered into, submit its final report to the President, the Congress, the Postal Service, and the labor, supervisory, and managerial organizations of the Postal Service.

(2) CONTENTS.—The report shall contain the findings, conclusions, and recommendations of the Academy on all matters required to be addressed by the study, and shall also include all written comments submitted to the Academy under subsection (b)(3).

(d) COOPERATION.—The Board of Directors shall take appropriate measures to ensure that all components of the Postal Service cooperate fully with the Academy in the conduct of its study under this section.

(e) DEFINITION.—For purposes of this section, the term “Board of Directors” has the meaning given such term by section 102 of title 39, United States Code (as amended by section 101 of this Act).

SEC. 602. RECOMMENDATIONS ON UNIVERSAL POSTAL SERVICES.

(a) IN GENERAL.—Chapter 28 of title 39, United States Code, is amended by adding at the end the following:

"§ 2806. Universal postal services

"(a)(1) Within 1 month after the date of enactment of this section, the Postal Service shall begin conducting a study the purpose of which shall be to develop recommendations as to the appropriate scope and standards for universal postal services to be assured by the Government of the United States consistent with its obligations under sections 101 and 403.

"(2) The Postal Service shall, within 18 months thereafter, complete its study and submit a written report to the President, the Congress, and the Postal Regulatory Commission setting forth its recommendations under this section and the reasons therefor.

"(3) The Postal Service shall solicit and include as part of its report the written views and suggestions of any persons who may be affected by or interested in any matter as to which the study pertains.

"(4) The conduct of the study and the drafting of the report required under this section shall, consistent with section 2805 (relating to inherently Governmental functions), be performed only by employees of the Postal Service.

"(b)(1) The recommendations submitted by the Postal Service under this section shall include recommendations concerning a universal service definition for each class of delivery services the continuous provision of which must, in the view of the Postal Service, be assured in order to fulfill the obligations set out in sections 101 and 403.

"(2) In developing its recommendations under this subsection with respect to any given class of delivery services, the Postal Service shall take into consideration the development of new technologies and the evolution of alternative means of meeting the public interest objectives set out in this title.

"(c) Each universal service definition recommended by the Postal Service under this section shall include the specification of minimum standards of service to be attained, consistent with the following:

"(1) Standards of reliability, speed, frequency, and quality of service shall be established so as to meet the needs of users and consumers of universal services generally.

"(2) Universal services should be available at just, reasonable, and affordable rates sufficient to enable universal services to be provided under best practices of honest, efficient, and economical management.

"(3) Persons in all regions of the Nation, including low-income persons and those located in rural, insular, and high-cost areas, should have access to universal postal services that are reasonably comparable to those provided in urban areas and that are available at appropriate rates. As provided in section 101(b), no small post office of the Postal Service shall be closed solely by reason of operating at a deficit.

"(4) In providing universal services, the Postal Service shall not, except as specifically authorized in this title, make any undue or unreasonable discrimination among users, including other providers of postal services.

"(5) Universal services shall be maintained without interruption and without abrupt and substantial changes in rates or quality of service.

"(6) Standards for universal service should avoid distortions in the competition between postal operators and between commercial purchasers of postal services to the extent consistent with fulfilling the obligations set out in sections 101 and 403.

"(7) Universal service definitions for the State of Alaska shall take into account the special conditions and needs of that State.

"(8) Universal services shall be provided consistent with such other principles as the Postal Service determines are necessary and appropriate for the protection of the public interest, convenience, and necessity, and the requirements of this title.

"(d) In addition to the principles set out in subsection (c), the Postal Service shall take into account special requirements for certain classes of postal services under this title, including requirements for uniform, reduced, or free rates."

(b) CLERICAL AMENDMENT.—The table of sections for chapter 28 of title 39, United States Code, is amended by adding at the end the following:

"2806. Universal postal services."

SEC. 603. STUDY ON EQUAL APPLICATION OF LAWS TO COMPETITIVE PRODUCTS.

(a) IN GENERAL.—The Department of Justice shall prepare and submit to the President and Congress, within 1 year after the date of enactment of this Act, a comprehensive report identifying Federal and State laws that apply differently to products of the United States Postal Service in the competitive category of mail (as

that term is defined in chapter 37 of title 39, United States Code, as amended by this Act) and similar products provided by private companies.

(b) RECOMMENDATIONS.—The Department of Justice shall include such recommendations as it considers appropriate for bringing such legal discrimination to an end.

(c) CONSULTATION.—In preparing its report, the Department of Justice shall consult with the United States Postal Service, the Postal Regulatory Commission, other Federal agencies, mailers, private companies that provide delivery services, and the general public, and shall append to such report any written comments received under this subsection.

SEC. 604. GREATER DIVERSITY IN POSTAL SERVICE EXECUTIVE AND ADMINISTRATIVE SCHEDULE MANAGEMENT POSITIONS.

(a) STUDY.—The Board of Directors shall study and, within 1 year after the date of enactment of this Act, submit to the President and Congress a report concerning the extent to which women and minorities are represented in supervisory and management positions within the United States Postal Service. Any data included in the report shall be presented in the aggregate and by pay level.

(b) PERFORMANCE EVALUATIONS.—The United States Postal Service shall, as soon as practicable, take such measures as may be necessary to ensure that, for purposes of conducting performance appraisals of supervisory or managerial employees, appropriate consideration shall be given to meeting affirmative action goals, achieving equal employment opportunity requirements, and implementation of plans designed to achieve greater diversity in the workforce.

(c) DEFINITION.—For purposes of this section, the term “Board of Directors” has the meaning given such term by section 102 of title 39, United States Code (as amended by section 101 of this Act).

SEC. 605. PLAN FOR ASSISTING DISPLACED WORKERS.

(a) PLAN.—The United States Postal Service shall, before the deadline specified in subsection (b), develop and be prepared to implement, whenever necessary, a comprehensive plan under which reemployment assistance shall be afforded to employees displaced as a result of the automation or privatization of any of its functions.

(b) REPORT.—Not later than 1 year after the date of enactment of this Act, the United States Postal Service shall submit to its Board of Directors (within the meaning of section 102 of title 39, United States Code, as amended by section 101 of this Act) and Congress a written report describing its plan under this section.

SEC. 606. CONTRACTS WITH WOMEN, MINORITIES, AND SMALL BUSINESSES.

The Board of Directors of the United States Postal Service shall study and, within 1 year after the date of enactment of this Act, submit to the President and the Congress a report concerning the number and value of contracts and subcontracts the Postal Service has entered into with women, minorities, and small businesses.

TITLE VII—INSPECTORS GENERAL

SEC. 701. INSPECTOR GENERAL OF THE POSTAL REGULATORY COMMISSION.

(a) IN GENERAL.—Paragraph (2) of section 8G(a) of the Inspector General Act of 1978 is amended by inserting “the Postal Regulatory Commission,” after “the United States International Trade Commission.”

(b) ADMINISTRATION.—Section 3604 of title 39, United States Code, is amended by adding after subsection (g) (as added by section 211) the following:

“(h)(1) Notwithstanding any other provision of this title or of the Inspector General Act of 1978, the authority to select, appoint, and employ officers and employees of the Office of Inspector General of the Postal Regulatory Commission, and to obtain any temporary or intermittent services of experts or consultants (or an organization of experts or consultants) for such Office, shall reside with the Inspector General of the Postal Regulatory Commission.

“(2) Except as provided in paragraph (1), any exercise of authority under this subsection shall, to the extent practicable, be in conformance with the applicable laws and regulations that govern selections, appointments and employment, and the obtaining of any such temporary or intermittent services, within the Postal Regulatory Commission.”

(c) DEADLINE.—No later than 180 days after the date of enactment of this Act—

(1) the first Inspector General of the Postal Regulatory Commission shall be appointed; and

(2) the Office of Inspector General of the Postal Regulatory Commission shall be established.

SEC. 702. INSPECTOR GENERAL OF THE UNITED STATES POSTAL SERVICE TO BE APPOINTED BY THE PRESIDENT.

(a) DEFINITIONAL AMENDMENTS TO THE INSPECTOR GENERAL ACT OF 1978.—Section 11 of the Inspector General Act of 1978 is amended—

(1) in paragraph (1)—

(A) by striking “and” before “the chief executive officer of the Resolution Trust Corporation”;

(B) by striking “and” before “the Chairperson of the Federal Deposit Insurance Corporation”;

(C) by striking “or” before “the Commissioner of Social Security, Social Security Administration”; and

(D) by inserting “or the Postmaster General and Chief Executive Officer of the United States Postal Service,” after “Social Security Administration”; and

(2) in paragraph (2)—

(A) by striking “or” before “the Veterans’ Administration”;

(B) by striking “or” before “the Social Security Administration”; and

(C) by inserting “or the United States Postal Service,” after “Social Security Administration”;

(b) SPECIAL PROVISIONS CONCERNING THE UNITED STATES POSTAL SERVICE.—

(1) IN GENERAL.—The Inspector General Act of 1978 is amended—

(A) by redesignating sections 8G (as amended by section 701(a)) and 8H as sections 8H and 8I, respectively; and

(B) by inserting after section 8F the following:

“SPECIAL PROVISIONS CONCERNING THE UNITED STATES POSTAL SERVICE

“SEC. 8G. (a) Notwithstanding the last two sentences of section 3(a), the Inspector General of the United States Postal Service shall report to and be under the general supervision of the Postmaster General, but shall not report to, or be subject to supervision by, any other officer or employee of the United States Postal Service or its Board of Directors. No such officer or employee (including the Postmaster General) or member of such Board shall prevent or prohibit the Inspector General from initiating, carrying out, or completing any audit or investigation, or from issuing any subpoena during the course of any audit or investigation.

“(b) In carrying out the duties and responsibilities specified in this Act, the Inspector General of the United States Postal Service shall have oversight responsibility for all activities of the Postal Inspection Service, including any internal investigation performed by the Postal Inspection Service. The Chief Postal Inspector shall promptly report the significant activities being carried out by the Postal Inspection Service to such Inspector General.

“(c) Any report required to be transmitted by the Postmaster General to the appropriate committees or subcommittees of the Congress under section 5(d) shall also be transmitted, within the 7-day period specified under such section, to the Committee on Government Reform and Oversight of the House of Representatives and the Committee on Governmental Affairs of the Senate.

“(d) Notwithstanding any provision of paragraph (7) or (8) of section 6(a), the Inspector General of the United States Postal Service may select, appoint, and employ such officers and employees as may be necessary for carrying out the functions, powers and duties of the Office of Inspector General and to obtain the temporary or intermittent services of experts or consultants or an organization of experts or consultants, subject to the applicable laws and regulations that govern such selections, appointments, and employment, and the obtaining of such services, within the United States Postal Service.

“(e) Nothing in this Act shall restrict, eliminate, or otherwise adversely affect any of the rights, privileges, or benefits of employees of the United States Postal Service, or labor organizations representing employees of the United States Postal Service, under chapter 12 of title 39, United States Code, the National Labor Relations Act, any handbook or manual affecting employee labor relations with the United States Postal Service, or any collective bargaining agreement.

“(f) There are authorized to be appropriated, out of the Postal Service Fund, such sums as may be necessary for the Office of Inspector General of the United States Postal Service.

“(g) As used in this section, ‘Postmaster General’, ‘Board of Directors’, and ‘Board’ each has the meaning given it by section 102 of title 39, United States Code.”

(2) RELATED PROVISIONS.—

For certain related provisions, see section 213(b).

(c) AUDITS OF THE POSTAL SERVICE.—

(1) AUDITS.—Subsection (e) of section 2008 of title 39, United States Code, is amended to read as follows:

“(e)(1) At least once each year beginning with the fiscal year commencing after the date of enactment of the Postal Modernization Act of 1999, the financial statements of the Postal Service (including those used in determining and establishing postal rates) shall be audited by the Inspector General or by an independent external auditor selected by the Inspector General.

“(2) Audits under this section shall be conducted in accordance with applicable generally accepted government auditing standards.

“(3) Upon completion of the audit required by this subsection, the person who audits the statement shall submit a report on the audit to the Postmaster General.”.

(2) RESULTS OF INSPECTOR GENERAL'S AUDIT TO BE INCLUDED IN ANNUAL REPORT.—Section 2402 of title 39, United States Code, is amended by inserting after the first sentence the following: “Each report under this section shall include, for the most recent fiscal year for which a report under section 2008(e) is available (unless previously transmitted under the following sentence), a copy of such report.”.

(3) COORDINATION PROVISIONS.—Subsection (d) of section 2008 of title 39, United States Code, is amended—

(A) by striking “(d) Nothing” and inserting “(d)(1) Except as provided in paragraph (2), nothing”; and

(B) by adding at the end the following:

“(2) An audit or report under paragraph (1) may not be obtained without the prior written approval of the Inspector General.”.

(4) SAVINGS PROVISION.—For purposes of any fiscal year preceding the first fiscal year commencing after the date of enactment of this Act, the provisions of title 39, United States Code, shall be applied as if the amendments made by this subsection had never been enacted.

(d) REPORTS.—

(1) IN GENERAL.—Section 3013 of title 39, United States Code, is amended—

(A) in the first sentence by striking “Postmaster General” and inserting “Chief Postal Inspector”; and

(B) by striking “Board” each place it appears and inserting “Inspector General”; and

(C) in the third sentence by striking “Each such report shall be submitted within sixty days after the close of the reporting period involved” and inserting “Each such report shall be submitted within 1 month (or such shorter length of time as the Inspector General may specify) after the close of the reporting period involved”; and

(D) by striking the last sentence and inserting the following:

“The information in a report submitted under this section to the Inspector General with respect to a reporting period shall be included as part of the semiannual report prepared by the Inspector General under section 5 of the Inspector General Act of 1978 for the same reporting period. Nothing in this section shall be considered to permit or require that any report by the Chief Postal Inspector under this section include any information relating to activities of the Inspector General.”.

(2) EFFECTIVE DATE.—This subsection shall take effect on the first day of the first semiannual reporting period beginning on or after the date of enactment of this Act and shall apply with respect to semiannual reporting periods beginning on or after the effective date of this subsection.

(3) SAVINGS PROVISION.—For purposes of any semiannual reporting period preceding the first semiannual reporting period referred to in paragraph (2), the provisions of title 39, United States Code, shall continue to apply as if the amendments made by this subsection had not been enacted.

(e) TECHNICAL AND CONFORMING AMENDMENTS.—

(1) RELATING TO THE INSPECTOR GENERAL ACT OF 1978.—(A) Subsection (a) of section 8H of the Inspector General Act of 1978 (as amended by section 701 and redesignated by subsection (b) of this section) is further amended—

(i) in paragraph (2) by striking “the Postal Regulatory Commission, and the United States Postal Service;” and inserting “and the Postal Regulatory Commission;” and

(ii) in paragraph (4) by striking “except that” and all that follows through “(Code);” and inserting “except that, with respect to the National Science Foundation, such term means the National Science Board;”.

(B)(i) Subsection (f) of section 8H of such Act (as so redesignated) is repealed.

(ii) Subsection (c) of section 8H of such Act (as so redesignated) is amended by striking "Except as provided under subsection (f) of this section, the" and inserting "The".

(2) RELATING TO TITLE 39, UNITED STATES CODE.—(A) Subsection (e) of section 202 of title 39, United States Code, is repealed.

(B) Paragraph (4) of section 102 of such title 39, as amended by sections 102(a) and 205(a) of this Act, is amended to read as follows:

"(4) 'Inspector General' means the Inspector General of the United States Postal Service, appointed under section 3(a) of the Inspector General Act of 1978;"

(C) The first sentence of section 1003(a) of such title 39 is amended by striking "chapters 2 and 12 of this title, section 8G of the Inspector General Act of 1978, or other provision of law," and inserting "chapter 2 or 12 of this title, subsection (b) or (c) of section 1003 of this title, or any other provision of law,".

(D) Subsection (b) of section 1003 of such title 39 is amended by striking "respective" and inserting "other".

(E) Subsection (c) of section 1003 of such title 39 is amended by striking "included" and inserting "includes".

(f) EFFECTIVE DATE; ELIGIBILITY OF PRIOR INSPECTOR GENERAL.—

(1) EFFECTIVE DATE.—

(A) IN GENERAL.—Except as provided in subparagraph (B) or in subsection (c) or (d), this section and the amendments made by this section shall take effect on the date of enactment of this Act.

(B) SPECIAL RULES.—

(i) IN GENERAL.—Except as provided in clause (ii), if the position of Inspector General of the United States Postal Service is occupied on the date of enactment of this Act (other than by an individual serving due to a vacancy arising in that position before the expiration of his or her predecessor's term), then, until January 5, 2004, or, if earlier, the date on which such individual ceases to serve in that position, title 39, United States Code, shall be applied as if the amendments made by this section had not been enacted.

(ii) AUTHORIZATION OF APPROPRIATIONS.—

(I) IN GENERAL.—Notwithstanding any other provision of this paragraph, subsection (f) of section 8G of the Inspector General Act of 1978 (as amended by this section) shall be effective for purposes of fiscal years beginning on or after October 1, 1999.

(II) SAVINGS PROVISION.—For purposes of the fiscal year ending on September 30, 1999, funding for the Office of Inspector General of the United States Postal Service shall be made available in the same manner as if this Act had never been enacted.

(2) ELIGIBILITY OF PRIOR INSPECTOR GENERAL.—Nothing in this Act shall prevent any individual who has served as Inspector General of the United States Postal Service at any time before the date of enactment of this Act from being appointed to that position pursuant to the amendments made by this section.

TITLE VIII—LAW ENFORCEMENT

Subtitle A—Amendments to

Title 39, United States Code

SEC. 801. MAKE FEDERAL ASSAULT STATUTES APPLICABLE TO POSTAL CONTRACT EMPLOYEES.

Section 1008 of title 39, United States Code, is amended—

(1) in subsection (a) by inserting "or entrusted with mail under contract with the Postal Service" after "mail"; and

(2) in subsection (b) by inserting "an employee of the Postal Service for the purposes of sections 111 and 1114 of title 18, and" after "deemed".

SEC. 802. SEXUALLY ORIENTED ADVERTISING.

(a) CIVIL PENALTY.—Section 3011 of title 39, United States Code, is amended—

(1) by redesignating subsections (b) through (e) as subsections (c) through (f), respectively; and

(2) by inserting after subsection (a) the following:

“(b)(1) Upon a finding by the court that a sexually oriented advertisement has been mailed in violation of section 3010(b), the court may assess, on whoever made the mailing or caused it to be made, a civil penalty of not less than \$500 and not more than \$1,500 for each violation. Each piece of mail sent in violation of section 3010(b) shall constitute a separate violation.

“(2) For purposes of this subsection—

“(A) receipt of a sexually oriented advertisement after the recipient’s name and address have been listed (as described in section 3010(b)) for at least 60 days shall create a rebuttable presumption that such advertisement was mailed more than 30 days after that individual’s name and address became so listed; and

“(B) receipt in the mail of a sexually oriented advertisement addressed to ‘Occupant’ or ‘Resident’ (or any other term permitted by Postal Service standards on simplified addressing) at the recipient’s address, or which is specifically addressed to the recipient, but with an inconsequential error or variation in the recipient’s name or address, shall, for purposes of applying the mailing prohibition of section 3010(b), create a rebuttable presumption that such advertisement was mailed to such recipient.

“(3) Any penalty assessed under paragraph (1) shall be paid to the Postal Service for deposit in the Postal Service Fund established by section 2003.”.

(b) REPEAL.—

(1) IN GENERAL.—Section 3008 of title 39, United States Code, and the item relating to such section in the table of sections at the beginning of chapter 30 of such title, are repealed.

(2) CONFORMING AMENDMENTS.—(A) Subsection (f) of section 3011 of such title 39 (as so redesignated by subsection (a)) is amended by striking “section 3006, 3007, or 3008” and inserting “section 3006 or 3007”.

(B) Section 1737 of title 18, United States Code, is amended—

(i) in subsection (a) by striking “3008 or”; and

(ii) in subsection (b) by striking “3008(a) or”.

(c) EFFECTIVE DATE.—This section and the amendments made by this section shall take effect 90 days after the date of the enactment of this Act. The amendments made by this section shall be treated as if they had never been enacted for purposes of any mailing made or caused to be made before this section takes effect.

SEC. 803. ALLOW POSTAL SERVICE TO RETAIN ASSET FORFEITURE RECOVERIES.

Paragraph (7) of section 2003(b) of title 39, United States Code, is amended to read as follows:

“(7) amounts (including proceeds from the sale of forfeited items) from any civil forfeiture conducted by the Postal Service and from any forfeiture resulting from an investigation in which the Postal Service has primary responsibility, except that nothing in this paragraph shall preclude the Postal Service, on such terms as it may determine, from sharing such amounts with any Federal, State, or local law enforcement agency which participated in any of the acts which led to the seizure or forfeiture of the property; and”.

SEC. 804. HAZARDOUS MATTER.

(a) CIVIL PENALTY.—Chapter 30 of title 39, United States Code, is amended by adding at the end the following:

“§ 3016. Civil penalty for prohibited mailing and deficient packaging of hazardous matter

“(a) For the purposes of this section—

“(1) the term ‘parcel’ includes any kind of package, envelope, container, or other piece of mail;

“(2) the term ‘manner’ includes the preparation and packaging of a piece of mail;

“(3) a person shall be considered to have acted knowingly if—

“(A) such person had actual knowledge of the facts giving rise to the violation; or

“(B) a reasonable person acting in the same circumstances and exercising due care would have had such knowledge; and

“(4) the term ‘hazardous matter’ has the meaning given such term by section 1716 of title 18.

“(b) Any person—

“(1) who knowingly mails or causes to be mailed any parcel, the contents of which constitute or include any hazardous matter which has been declared by statute or Postal Service regulation to be nonmailable under any circumstances;

“(2) who knowingly mails or causes to be mailed a parcel in violation of any statute or Postal Service regulation restricting the time, place, or manner in which hazardous matter may be mailed; or

“(3) who knowingly manufactures, distributes, or sells any container, packaging kit, or similar device that—

“(A) is represented, marked, certified, or sold by such person for use in the mailing of any hazardous matter; and

“(B) fails to conform with any statute or Postal Service regulation setting forth standards for containers, packaging kits, or similar devices used for the mailing of hazardous matter;

shall be liable to the Postal Service for a civil penalty in an amount not to exceed \$25,000 per violation.

“(c) The Postal Service may enforce this section by commencing a civil action in accordance with section 409(d). The action may be brought in the district court of the United States for the district in which the defendant resides or any district in which the defendant conducts business or in which a violation of this section was discovered.

“(d) In determining the amount of any civil penalty to be assessed under this section, the district court—

“(1) shall treat as a separate violation—

“(A) each parcel mailed or caused to be mailed as described in paragraph (1) or (2) of subsection (b); and

“(B) each container, packaging kit, or similar device manufactured, distributed, or sold as described in subsection (b)(3); and

“(2) shall take into account—

“(A) the nature, circumstances, extent, and gravity of each violation committed; and

“(B) with respect to the person found to have committed such violation, the degree of culpability, any history of prior offenses, ability to pay, effect on ability to continue to do business, and such other matters as justice may require.

“(e) All penalties collected under authority of this section shall be paid into the Postal Service Fund established by section 2003.”

(b) CLERICAL AMENDMENT.—The table of sections at the beginning of chapter 30 of title 39, United States Code, is amended by adding at the end the following:

“3016. Civil penalty for prohibited mailing and deficient packaging of hazardous matter.”

Subtitle B—Other Provisions

SEC. 811. STALKING FEDERAL OFFICERS AND EMPLOYEES.

(a) IN GENERAL.—Chapter 41 of title 18, United States Code, is amended by adding at the end the following:

“§ 881. Stalking Federal and postal officers and employees

“(a) Whoever—

“(1) repeatedly engages in conduct (including maintaining a visual or physical proximity or communicating a verbal or written threat) directed at another person who is or was an officer or employee—

“(A) in the executive, legislative, or judicial branch of the Federal Government; or

“(B) in the United States Postal Service;

while such other person is engaged in official duties or on account of such duties;

“(2) knows that such conduct is likely to place that other person in reasonable fear of sexual battery, bodily injury, or death; and

“(3) thereby induces such fear in that other person;

shall be punished as provided in subsection (b) of this section.

“(b)(1) The punishment for an offense under subsection (a) is—

“(A) in the case of a first conviction under such subsection—

“(i) if, during the commission of the offense, the offender uses a deadly or dangerous weapon, a fine under this title or imprisonment for not more than 10 years, or both;

“(ii) if the offense violates a protective order, a fine under this title or imprisonment for not more than 5 years, or both; and

“(iii) in any other case, a fine under this title or imprisonment for not more than 3 years, or both; and

“(B) in the case of a second or subsequent conviction under such subsection, a fine under this title or imprisonment for not more than 15 years, or both.

“(2) If a sentence of probation is imposed for an offense under this section, the court shall require the defendant to undergo appropriate psychiatric, psychological, or social counselling.

“(c)(1) Whoever is aggrieved by a violation of this section may, in a civil action, obtain appropriate relief from the person engaging in that violation. Such relief may include compensatory and punitive damages, and injunctive or declaratory relief, and shall include reasonable attorney’s fees.

“(2) If—

“(A) the court issues an injunction under this subsection;

“(B) the person against whom the injunction is issued is an officer or employee in the executive branch of the Federal Government or in the United States Postal Service; and

“(C) there is a nexus between the enjoined conduct and such person’s office or employment;

the court may order that the person be suspended or summarily discharged from such office or employment.

“(d) As used in this section, the term ‘protective order’ means any court order that requires an individual—

“(1) to refrain from behavior prohibited by subsection (a); or

“(2) to refrain from contact with the person who subsequently is a victim of the offense under such subsection that is committed by that individual.”

(b) CLERICAL AMENDMENT.—The table of sections at the beginning of chapter 41 of title 18, United States Code, is amended by adding at the end the following:

“881. Stalking Federal and postal officers and employees.”.

SEC. 812. NONMAILABILITY OF CONTROLLED SUBSTANCES.

Section 1716 of title 18, United States Code, is amended by adding at the end the following:

“Whoever knowingly deposits for mailing or delivery, or knowingly causes to be delivered by mail, according to the direction thereon, or at any place at which it is directed to be delivered by the person to whom it is addressed, unless in accordance with the rules and regulations authorized to be prescribed by the Postal Service, any controlled substance, as that term is defined for the purposes of the Controlled Substances Act, shall, if the distribution of a like amount of such substance is a felony under such Act, be fined under this title or imprisoned not more than 5 years, or both.”.

SEC. 813. ENHANCED PENALTIES.

Pursuant to its authority under section 994 of title 28, United States Code, the United States Sentencing Commission shall amend its sentencing guidelines to—

(1) appropriately enhance penalties in cases in which a defendant is convicted of stealing or destroying a quantity of undelivered United States mail, in violation of sections 1702, 1703, 1708, 1709, 2114, or 2115 of title 18, United States Code; and

(2) establish that the intended loss in a theft of an access device as defined in section 1029(e)(1) of title 18, United States Code, shall be based on the credit line of the access device or the actual unauthorized charges, whichever amount is greater.

SEC. 814. POSTAL BURGLARY PROVISIONS.

(a) LARCENY INVOLVING POST OFFICE BOXES AND POSTAL STAMP VENDING MACHINES.—Section 2115 of title 18, United States Code, is amended—

(1) by striking “or” before “any building”;

(2) by inserting “or any post office box or postal products vending machine,” after “used in whole or in part as a post office,”; and

(3) by inserting “or in such box or machine,” after “so used”.

(b) RECEIPT, POSSESSION, CONCEALMENT, OR DISPOSITION OF PROPERTY.—Section 2115 of title 18, United States Code, is amended—

(1) by inserting “(a)” before “Whoever”; and

(2) by adding at the end the following:

“(b) Whoever receives, possesses, conceals, or disposes of any mail matter, money, or other property of the United States, that has been obtained in violation of this section, knowing the same to have been unlawfully obtained, shall be fined under this title or imprisoned not more than 5 years, or both.”.

SEC. 815. MAIL, MONEY, OR OTHER PROPERTY OF THE UNITED STATES.

(a) ENHANCED PENALTY FOR ROBBERY.—Subsection (a) of section 2114 of title 18, United States Code, is amended to read as follows:

“(a) ASSAULT.—Whoever assaults any person having lawful charge, control, or custody of any mail matter or of any money or other property of the United States, with intent to rob, steal, or purloin such mail matter, money, or other property of the United States, or robs or attempts to rob any such person of mail matter, or of any money, or other property of the United States, shall, for the first offense, be imprisoned not more than 10 years or fined under this title, or both. If, in effecting or attempting to effect such robbery the defendant wounds the person having custody of such mail, money, or other property of the United States, or puts that person's life in jeopardy by the use of a dangerous weapon, or the offense is a subsequent offense under this subsection, the defendant shall be imprisoned not more than 25 years or fined under this title, or both. If the death of any person results from the offense under this subsection, the defendant shall be punished by death or life imprisonment.”

(b) ATTEMPT OFFENSES.—

(1) The second paragraph of section 501 of title 18, United States Code, is amended by striking “uses or sells,” and inserting “uses or sells or attempts to use or sell.”

(2) Section 1711 of title 18, United States Code, is amended by inserting “attempts to loan, use, pledge, hypothecate, or convert to this own use,” after “converts to his own use.”



Mr. MCHUGH. We have four panels this morning and in all likelihood into this afternoon. Like all of you, we are here to listen to them and to review their comments. I would ask unanimous consent that my prepared statement be entered into the record in its entirety, as I would also ask unanimous consent that all Members have that opportunity to do so, as well.

[The prepared statement of Hon. John M. McHugh follows:]

Statement of the Honorable John M. McHugh, Chairman
 Subcommittee on the Postal Service
 H.R. 22 Hearing – February 11, 1999

Good Morning. The Subcommittee's first meeting in the 106th Congress will come to order. I welcome all of my colleagues. I take it as a positive sign that on both sides of the aisle, all Members chose to return to the Subcommittee, and the only Member we lost, Mr. Sessions, was a result of his new position on the Rules Committee.

The Subcommittee has existed for four years, and in that time we have researched, analyzed, developed, proposed, and revised a bill to fundamentally modernize our nation's postal laws for the first time since 1970. My guiding principle has been to do it right, not quickly. Indeed, throughout this 4 year process, we have attempted to ensure that the public and all postal stakeholders have had repeated opportunities to provide input on the original legislation and the subsequent revisions. H.R. 22, the Postal Modernization Act of 1999, is the exact same bill that passed our Subcommittee in a bipartisan manner at the end of the 105th Congress. Although H.R. 22 is now a well-refined bill with a long history of numerous hearings and public commentary behind it, we continue the open and methodical process today with the first of two comprehensive hearings on the current version.

Our first witness will be the Postmaster General and Chief Executive Officer of the U.S. Postal Service, William Henderson. It was his predecessor's call for reform of the current regulatory system four years ago

that was probably the most important factor in starting the Subcommittee on this journey. This past Christmas Eve, and then again just two and a half weeks ago, the Postmaster General provided us with suggested amendments that address the remaining areas of concern for the Postal Service with the current version of the bill. I very much welcome his constructive engagement in this endeavor, and look forward to exploring some of the specifics of his proposals this morning.

Our second panel will be comprised of the five Postal Rate Commissioners, led by the Chairman, Edward Gleiman. In addition to welcoming back Chairman Gleiman and Vice Chairman LeBlanc, this is the Subcommittee's first opportunity to also hear from the three newest Commissioners, Commissioner Omas, Commissioner Goldway, and Commissioner Covington. In the past four years, the entire Postal Rate Commission – in particular Chairman Gleiman – has been an invaluable partner in many of the Subcommittee's efforts. Time and again the Commission has provided its expertise in helping us improve and strengthen H.R. 22. And again today we welcome the Commission's comments, insights, and suggestions.

Our third and fourth panels will be comprised of the Postal Service's three management associations and four major unions. While H.R. 22 reflects a comprehensive and balanced – and I want to emphasize the word “balanced” – approach toward addressing the needs and concerns of all interested parties, primary among these interests are the loyal, dedicated, and hardworking employees of the U.S. Postal Service. The current version of H.R. 22 reflects the many suggestions that the employees have put forth.

When they have raised serious and legitimate concerns, we have responded with appropriate modifications: whether it was redesigning a price cap system to specifically recognize wages and benefits, and respect the collective bargaining process; modifying the scope of the monopoly to maintain its wide coverage; moving the universal service study solely in the purview of the Postal Service; changing the labor-management relations study from an outside commission to a process where all parties have a voice; dropping some provisions such as the mailbox demonstration project or the appeals of MSPB decisions; or adding a labor representative to the Board. I look forward to continuing this dialogue with the employee groups when they testify today.

The details of H.R. 22 have been before us for quite some time, and I won't review them here. The purpose of H.R. 22 is twofold: to give the Postal Service greater freedom and enhanced tools to compete while establishing new rules to ensure fair competition and protect the public interest.

Although it is obvious to those who understand H.R. 22, I must clear the air regarding what appears to be some confusion about this bill, even by a witness in one of the later panels. As the Postmaster General will point out in his testimony, a price cap replaces cost-of-service regulation with an incentive based regulatory system. However, because a few provisions of H.R. 22 are adapted from the Federal Communications Commission's experience with incentive regulation, some have suggested that this bill is the same thing as telecom reform, or the break-up of AT&T, or even equivalent to deregulation generally such as in aviation. The comparison

has been made, in my opinion, to subtly suggest that the negative effects of those efforts will result from modernizing our nation's postal laws. I believe the analogy is illogical and inaccurate.

H.R. 22 is not about "breaking up" the Postal Service, as the court system required of AT&T, nor is it about trying to force competition into the postal and delivery sector, as Congress attempted to do when it deregulated the airlines and telecom. The postal system is already fiercely competitive. H.R. 22 simply recognizes that we will doom the Postal Service to failure unless we act to update our nation's laws so that the Service can adapt, compete, grow, and survive in carrying out its universal service mission well into the 21st century.

And it will take some time for the Postal Service to adapt. H.R. 22, if enacted today, would set in motion a series of reforms that will probably not be fully implemented until some time in 2007, the end of the first five-year rate cycle. Those who support amendments or alternatives to H.R. 22 must keep such timeframes in mind. Reasoned and gradual change is the friend of all who wish to see a healthy and efficient postal system in the next century.

Mr. McHUGH. We have today, as I said, four panels. Our lead panelist, of course, is the distinguished Postmaster General of the United States, William Henderson. This is the PMG's first appearance for this year and we're welcoming him once again. And, of course, our continued best wishes.

We also have, on our second panel, the Postal Rate Commission members led by its chairman, Edward Gleiman, and five of its members. I will extend to him the honor of introducing them at the appropriate time. Our third and fourth panels will be comprised of the Postal Service's three management associations and its four major unions.

I also wish to state that there is a need to clear the air in one regard with what appears to be some confusion about this bill, as we may hear from one of the witnesses on a later panel.

As the Postmaster General will point out in his testimony, and I know this because I've read it as I've read all of the pre-prepared testimony, a price cap replaces cost of service regulation with an incentive-based regulatory system. However, because of a few provisions of H.R. 22 being adopted from the Federal Communications' experience with incentive regulations, some in the postal community have suggested that this bill, H.R. 22, is the same thing as telecom reform, or even the breakup of AT&T, or equivalent to deregulation of such sectors as the aviation industry.

Comparison has been made, in my opinion, to suggest, albeit subtly, that the negative effects of some of those efforts will somehow be felt again, if and when we modernize our Nation's postal laws. I want to state that I believe that analogy is certainly inaccurate and, I would argue, it's rather illogical as well.

H.R. 22 is not about breaking up the Postal Service as the courts required in the case of AT&T. Nor is it about trying to force competition into the postal and delivery sectors as Congress did indeed attempt to do when it deregulated both the airline industry and the telecom industry.

The Postal Service is already fiercely competitive. I think all of us understand that. H.R. 22 simply recognizes that we will doom the Postal Service to failure unless we act to update our Nation's laws so that the Service can adapt, compete, grow and survive in carrying out its universal service mission well into the 21st century.

And it will take some time for the Postal Service to adapt, even if H.R. 22 were enacted today, and I don't believe we're going to do that, are we? No, not today. But even if that were the case, it would set into motion a series of reforms that would probably not be fully implemented until some time in the year 2007, which would be the end of the first 5-year rate cycle.

Those who support amendments or alternatives to H.R. 22 must, I think, keep those kinds of timeframes in mind. Certainly reasoned and gradual change is the friend of all who wish to see a healthy and efficient Postal Service into the next century.

So with that little editorialization aside, again, I welcome you all. Before I yield to my friend from the great State of Pennsylvania, the ranking minority member, I would like to yield to the chairman of the full committee, the gentleman from Indiana, Mr. Burton, for

any comments he may wish to make, and certainly with our appreciation for his joining us here this morning. Mr. Chairman.

Mr. BURTON. Thank you, Chairman McHugh. First of all I want to congratulate you and thank you for all the hard work you and the ranking member have done over the past 4 years to bring this bill to this point. I don't know of anybody else in the Congress who would have liked to have done this job.

I'm not sure that you really wanted to do it but you've done an outstanding job, and it's a real testimony to you. And I hope your constituents are watching because they ought to know how hard you worked on this as well.

This bill is a very important bill. And it's one that I'm particularly interested in. That's why I decided to be a co-sponsor with Chairman McHugh. I'd like to first state that although a lot of the provisions in the bill are extremely good, nothing is in concrete. It's still a fairly fluid document although we're probably going to use 90 percent of it.

But I've met with Chairman McHugh and some other people from other areas of the postal community and private sector and they still have some differences of opinion. I understand that there may be as many as 75 to 100 or maybe more amendments. We hope to pare that down. But over the next few weeks, we're going to be meeting again and Chairman McHugh is going to bring me up to date, because I'm not as conversant with this subject as I want to be before we bring it to the full committee.

I'm going to try to make sure that we accommodate as many people as possible. There needs to be level playing field so that the private sector and the Postal Service can compete fairly with one another, and there is still some concern about that.

Last year the then Postmaster came to see me about the postal rates and the rate increase that was about to take place. And just to let you know that our committee does not have the latitude that I would like for it to have, I told him that I thought the 1 cent increase in the price of postage was not necessary, because there had been over \$1 billion in black ink in the previous financial statement by the Postal Service and last year was well over \$500 million. And we didn't think a postal rate increase was necessary.

Nevertheless, the Postal Rate Commission didn't agree with us and they went ahead and increased that. Those are some of the concerns that we've had in the past and although this bill doesn't address them, it's one of the things that I'm concerned about in the future. That's why I'm particularly concerned about this one provision that you were talking about just a few moments ago.

Let me just make sure I cover all my notes. I don't think I want to go into all the details that may be of concern to me in the bill because I think most of you are familiar with those. But I think in the next 10 years or so we're going to see a radical change in the way we communicate with one another.

Faxes have become a way of life, e-mails have become a way of life. And unless we come out with something that realizes that fact, we're going to have rates going up in the Postal Service, because people will be shifting into these electronic means of communication and the Service may suffer as a result of that.

These are things that have to be addressed, so that while communication moves into the 21st century we're still providing the best service for the people of this country at the lowest possible cost.

I'd like to submit, Mr. Chairman, my entire statement for the record, but I want all of those interested parties to know that Chairman McHugh has asked me to sit down with him, and I've asked him to sit down with me and interested members of the various communities who are interested in this bill to talk about some final changes that might fine tune this bill to make it even better than it already is. And we're going to be working very hard to make sure that's accomplished in the next few weeks.

But let me just say one more time that I don't know of anybody in the Congress that could have done as good a job as Chairman McHugh has over the past 4 years, with all the interested parties and all the diverse opinions on how this ought to be done, than he has. And so I want to congratulate him once again and tell him I'm very proud of him and I look forward to working with him to get the final product completed. Thank you.

[The prepared statement of Hon. Dan Burton follows:]

STATEMENT OF THE HONORABLE DAN BURTON
Subcommittee on the Postal Service
February 11, 1999

Today the Postal Service Subcommittee is holding its first of two hearings on H.R. 22, the Postal Modernization Act of 1999. I am pleased to be an original cosponsor of this legislation. As Chairman of the Government Reform Committee, I have made passing a postal reform bill one of the Committee's top priorities this year.

I especially want to take this opportunity to commend Chairman McHugh for his hard work -- for over four years now -- on behalf of postal reform. John McHugh has undertaken a Herculean task and he has brought this bill a long way.

Yet much work remains to be done in order to pass postal reform. While many in the postal community support the goals of H.R. 22, there are significant differences of opinion regarding the specific provisions of this bill. This bill is still a work in progress. Let me reassure those who are here today and the American public that this bill is written in ink, not in concrete. There will be opportunities as the legislative process continues to improve the bill. The purpose of this hearing, and the hearing next month, is to identify concerns about H.R. 22 and look for ways to address them.

As the Chairman of this Committee and a ten-year veteran of the old Post Office and Civil Service Committee, I believe a postal reform bill must follow two principles. First, it must allow the Postal Service to modernize and compete in the 21st Century. And secondly, it must be put on a level playing field with its private sector competitors.

Today's witnesses include Postmaster General Bill Henderson, Postal Rate Commission Chairman Ed Gleiman and other members of the Postal Rate Commission, and representatives of postal employee organizations. I would like to welcome all of these witnesses today.

H.R. 22 is identical to last year's bill, which was approved by the Subcommittee. Since the postal community is already quite familiar with the contents of H.R. 22, I will focus my comments on the need for this legislation.

The future threat to the Postal Service should be very clear to all of us here today, despite the Postal Service's success in recent years. Many observers ask why do we need postal reform now when the Postal Service is financially strong and providing excellent service? We went four years without a postage rate increase, and I believe even that increase was unnecessary. But rapid changes in communication technology, which are now taking place, don't allow Congress and the Postal Service the luxury of an "if it ain't broke, don't fix it" attitude.

Every day more and more communication is shifted from traditional paper mail to electronic mail. In the 1980s and early 1990s we saw fax machines come into wide use,

and now in the late 1990s we are seeing e-mail rapidly increase in popularity. Technological change is happening so fast that I'm hesitant to predict how Americans will communicate in the next decade and beyond, other than the fact that it probably won't be on pieces of paper in envelopes! Yet despite these changes, our nation still needs to maintain quality, universal mail service. This service needs to remain affordable for all Americans. But if current trends continue, and there is certainly every reason to believe that they will, the Postal Service will have significantly lower revenues and less first-class mail to deliver. While at the same time still being mandated by law to provide universal service at uniform rates across America. This is something the Postal Service, as it is currently structured, will not be able to do. Either postage rates will increase dramatically or service will suffer, or both. As Chairman of the Government Reform Committee, I find this unacceptable.

At the risk of oversimplifying a rather extensive and complex set of changes, I think it's fair to say that H.R. 22 has two primary goals: modernization of the Postal Service to ensure the continuation of universal, affordable mail service into the 21st century, and ensuring a level playing field in those areas where the Postal Service competes with private sector businesses. H.R. 22 envisions a Postal Service that is *competitive*, but also *competes fairly* with private companies.

H.R. 22 offers the Postal Service flexibility to succeed in a businesslike manner in the rapidly changing world of communications. At the same time H.R. 22 protects the consumer by requiring the Postal Service to operate more efficiently, and limits rate increases.

Again, I welcome our witnesses, and I look forward to your testimony on H.R. 22 and the future of the Postal Service.

Mr. MCHUGH. Well, thank you, Mr. Chairman. I deeply appreciate those kind comments. We've had a lot of great help, a lot of support on both sides on the aisle. And particularly, Mr. Chairman, with your leadership and your input and assistance, we've come a long way and I thank you for that. With that it's my pleasure now to yield to the gentleman from Pennsylvania, Philadelphia, PA, to be specific, the ranking minority member, Chaka Fattah.

Mr. FATTAH. Thank you, Mr. Chairman. And to the full committee chairman, it is, I think for all of us an important step as we approach the possibility of a mark-up on H.R. 22. Postal reform is something, as Chairman Burton has mentioned, and also the chairman of this subcommittee has made it very clear is important to a number of the stakeholders who are in this room and who we will be hearing from today, both the unions and the others who are involved in the implementation of postal service.

We have mailers and we have private sector competitors to the Postal Service. But there is, in the final analysis, another group of shareholders who won't be directly represented in the testimony today that we need to keep uppermost in our mind, and that is the citizenry of our country who depend every day on the U.S. Postal Service to provide a universal service to them. They, above and beyond the other stakeholders should be the focus of our efforts at reform.

I know that for my good friend, the gentleman from New York, that this will be a central focus of our work as we go forward. And that we do want to ease any unfair burden on those who are private sector participants in this process. But we cannot assume something that is not the case, and that is that they somehow are in the same business as the U.S. Postal Service.

There is only one U.S. Postal Service, there is only one entity with the burden and the responsibility given to them by the Congress to deliver mail anywhere in this country, notwithstanding the economics of it, and to do that in an efficient and an effective manner. So I want to thank the Postmaster General, who we will hear from, for his leadership. He is doing an excellent job and also keeping us informed as it relates to his work.

I want to welcome, I understand we have a new committee member, Mr. Miller, from Florida, who is not with us yet today, but welcome him to the subcommittee. There is a lot going on today. I have Secretary Riley down the hall in another committee hearing. But there is always a lot going on in the Congress so we'll try to manage it as well as we can.

I'll offer some formal remarks for the record, as we go forward. And I look forward to being engaged in this activity. The postal reform is now fully on the front burner of the full committee. And I think we can tell by the chairman's presence here this morning that he intends to have some action in this regard. Thank you.

Mr. MCHUGH. I thank the gentleman. I particularly thank him for his very active leadership on this subcommittee and for his role in assisting the effort that we're all concentrating on and the purpose for our meeting here this morning. Let me yield now to the dean of the New York State delegation, a good friend and certainly a leader of longstanding on postal issues, a gentleman, as I said,

from New York, Mr. Gilman, for any comments he may wish to make.

Mr. GILMAN. Thank you, Mr. Chairman, I'll be brief because I know we have some important participants this morning that we want to hear from. I want to commend you and the ranking minority member, Chaka Fattah, for the wonderful work you've been doing in taking what occurred over the last session, putting it into the new revised H.R. 22, the Postal Reform Act, which I'm sure with a lot of good work by all of us can help to make our Postal Service even better.

It's still one of the best in the world, and we commend our Postmaster General, who is here, for making certain that we are right up there, up front, compared to other postal services around the world, and I've had an opportunity to visit a number of them.

But I want to thank you, Mr. Chairman, for your persistence and patience in the extensive work you've been doing to bring this about. We know the kind of hard work it's been in gathering all of the evidence, and listening to all of the testimony.

As the chairman is well aware, there is a great need to ensure that our Postal Service will be adequately prepared to meet the needs of our ever expanding competitive market in the 21st century and all of the technological improvements that are taking place in communication.

Since serving on the initial House Post Office and Civil Service Committee, and I see some folks who've been with us for a number of years out there, I've been a strong advocate of making certain that the Postal Service provide adequate service to its customers for years to come while simultaneously maintaining a good work environment that continues to honor its commitment to its employees. The biggest part of our Postal Service, of course, is over 700,000 postal workers who serve our Nation. And it's so important that they have input and that they be assured that there is input in this measure.

I think the bill before us accomplishes a number of major goals, and I'm certain we'll hear some other proposals that should be added. It's important to note that the public and all postal stakeholders have related opportunities to provide input and revisions under H.R. 22, and I'm sure today's testimony will give us some additional constructive ideas. In fact, we've heard nothing but praise for both the chairman and the open process from those who visited with me to discuss this measure.

In that regard, I was pleased to be able to seek approval of an amendment to this measure during our subcommittee's mark-up in the last Congress, which is included in the chairman's introduction of the bill to the Congress. That amendment protects the rights, the privileges and benefits of both employees of the Postal Service and the labor unions representing them, and stems from some of the concerns that arose from the Postal Union in regard to the postal regulatory portion of the bill.

Accordingly, with H.R. 22's inclusion of that amendment, it's now the sense of the Congress that nothing in a Postal Rate Commission section should restrict, expand or otherwise affect any of the rights, privileges or benefits of either employees of the U.S. Postal Service or labor organizations representing those employees, as es-

tablished under the National Labor Relations Act. And this measure may not be a perfect bill, but it's close to one. I think the postal community should support the shape and operation of our Postal Service.

Remaining concerns can and I'm certain will be discussed as this process continues in the subcommittee, in our full committee, and onto the floor. And I want to again commend you for moving it forward at this early stage in this session. And I encourage all parties who want to be part of the solution to come to the table or, as they say, "If you don't come now the train will be leaving the station very shortly." Thank you, Mr. Chairman.

[The prepared statement of Hon. Chaka Fattah follows:]

Mr. Chairman:

I would like to join you, Mr. Chairman in welcoming Congressman Dan Miller (R-FL), to our Subcommittee. Not only is this our first hearing since we have organized, it is also the first hearing this Congress on H.R. 22, the Postal Modernization Act of 1999.

Along with greeting our new colleague, I must also take the time to welcome a new member of the Postal Rate Commission, Commissioner Dana B. "Danny" Covington. Besides recognizing new members and commissioners, I extend greetings to our panelists and look forward to your testimony.

In reviewing the testimony to be presented today, I was struck by how forthcoming your remarks are and how much of a "work in progress" postal reform will truly be. I was also struck by the enormous job we, as Members of Congress have in making sure that the public -- not just the mailers, competitors, and established postal community -- understands and will benefit from postal reform.

Along that line, I have broken down the postal reform issue into three key words: People, Prices and Service. My meaning is a bit different from the words uttered by former Postmaster General Marvin Runyon, who when calling upon Congress to "reform" the Postal Service Reorganization Act of 1970, asked for regulatory relief in the areas of "People, Prices and Products."

As I see it, the task before us is to ensure the preservation and continuation of universal service to all Americans -- to all people. And, to do so at reasonable prices along with an increase in postal services available to the public; not, a decrease or degradation in the quality and quantity of services rendered to consumers.

The people aspect also encompasses jobs -- postal jobs. Just how will postal employees, the movers and carriers of our mail, fare? Will their jobs shift to other areas, other companies or will they just disappear. How will such change impact mail delivery, mail services and universal service? These are critical questions which must be answered in our quest to reform the postal service.

As the recent Associated Press poll released last month showed, "almost three-fourths of Americans believe the Postal Service is doing and excellent or good job." When pressed, those polled indicated that their biggest concerns are the speed of mail delivery, the cost of stamps and counter service.

With that as our backdrop, I look forward to working with the Chairman, my colleagues and those testifying before us, in refining postal reform legislation. I am sure that Chairman McHugh would agree that we have come a long way from the first time Marvin Runyon requested a simplified and shortened rate making process, the ability to offer volume discounts and bring new products to the marketplace in a more timely manner, and replace the current collective bargaining and grievance arbitration process.

Thank you.

Mr. MCHUGH. I thank you for your comments here today, and more importantly, for your work not just now but over so many years on behalf of this very important organization.

Mr. GILMAN. Mr. Chairman.

Mr. MCHUGH. Yes.

Mr. GILMAN. If you'll forgive me.

Mr. MCHUGH. Certainly.

Mr. GILMAN. I'm chairing a mark-up in my own committee, but I will be coming back and forth and I will ask my staff to stand by. Thank you, Mr. Chairman.

[The prepared statement of Hon. Benjamin Gilman follows:]

Remarks by Rep. Gilman
H.R. 22, the Postal Reform Act
September 24, 1998

THANK YOU MR. CHAIRMAN....

I AM PLEASED TO PARTICIPATE IN TODAY'S
HEARING ON H.R. 22, THE POSTAL REFORM ACT...

I WANT TO CONGRATULATE THE CHAIRMAN FOR
HIS PERSISTENCE AND HARD-WORK DURING THE
PAST FOUR YEARS WITH REGARD TO THIS
IMPORTANT ISSUE. THOUGH, I WOULD EXPECT NO
LESS FROM A FELLOW NEW YORKER.

AS THE CHAIRMAN IS WELL AWARE, THERE IS A GREAT NEED TO ENSURE THAT THE POSTAL SERVICE WILL BE ADEQUATELY PREPARED TO MEET THE NEEDS OF AN EVER EXPANDING AND COMPETITIVE POSTAL SYSTEM MARKET IN THE 21ST CENTURY.

SINCE SERVING ON THE ORIGINAL HOUSE POST OFFICE AND CIVIL SERVICE COMMITTEE, I HAVE BEEN A STRONG ADVOCATE OF ASSURING THAT THE POSTAL SERVICE PROVIDE ADEQUATE SERVICE TO ITS CUSTOMERS FOR YEARS TO COME, WHILE SIMULTANEOUSLY MAINTAINING A WORK ENVIRONMENT THAT CONTINUES TO HONOR ITS COMMITMENT TO ITS EMPLOYEES.

THE BILL BEFORE US TODAY, IS ONE THAT I
BELIEVE ACCOMPLISHES THESE GOALS...

IT IS IMPORTANT TO NOTE THAT THE PUBLIC
AND ALL POSTAL STAKEHOLDERS HAVE HAD
REPEATED OPPORTUNITIES TO PROVIDE INPUT AND
REVISIONS TO H.R. 22.

IN FACT, I HAVE HEARD NOTHING BUT PRAISE
FOR BOTH THE CHAIRMAN AND HIS OPEN PROCESS
FROM THOSE WHO HAVE VISITED WITH ME TO
DISCUSS H.R. 22...

IN THIS REGARD, I WAS SUCCESSFUL IN SEEKING
APPROVAL OF AN AMENDMENT TO HR 22 DURING
OUR SUBCOMMITTEE'S MARK-UP LAST CONGRESS,
WHICH HAS BEEN INCLUDED IN CHAIRMAN
McHUGH'S H.R. 22 INTRODUCTION THIS CONGRESS.

THIS AMENDMENT PROTECT THE RIGHTS,
PRIVILEGES, AND BENEFITS OF BOTH EMPLOYEES OF
THE POSTAL SERVICE AND THE LABOR UNIONS
REPRESENTING THEM, AND STEMS FROM SOME
CONCERNS THAT AROSE FROM THE POSTAL UNIONS
WITH REGARD TO THE POSTAL REGULATORY
PORTION OF THE BILL.

ACCORDINGLY, WITH H.R. 22's INCLUSION OF MY AMENDMENT, IT IS NOW THE SENSE OF THE CONGRESS THAT NOTHING IN THE POSTAL REGULATORY COMMISSION SECTION SHOULD RESTRICT, EXPAND, OR OTHERWISE AFFECT ANY OF THE RIGHTS, PRIVILEGES, OR BENEFITS OF EITHER EMPLOYEES OF THE UNITED STATES POSTAL SERVICE, OR LABOR ORGANIZATIONS REPRESENTING EMPLOYEES OF THE UNITED STATES POSTAL SERVICE AS ESTABLISHED UNDER THE NATIONAL LABOR RELATIONS ACT.

H.R. 22 MAY NOT BE A PERFECT BILL, BUT IT IS
CLOSE AND ONE THAT I THINK THE POSTAL
COMMUNITY SHOULD SUPPORT TO SHAPE THE
OPERATION OF THE NATION'S POSTAL SYSTEM...

REMAINING CONCERNS CAN AND I AM SURE
WILL BE DISCUSSED AS THE PROCESS CONTINUES IN
THE SUBCOMMITTEE, FULL COMMITTEE, AND ON TO
THE HOUSE FLOOR.

ACCORDINGLY, I ENCOURAGE ALL PARTIES WHO
WANT TO BE PART OF THE SOLUTION TO COME TO
THE TABLE OR BE PREPARED TO BE LEFT BEHIND.

THANK YOU....

Mr. MCHUGH. I understand. You have my proxy, Mr. Chairman. With that, I'd be happy to yield to one of the few Members that I'm aware of that actually lobbied to get on this subcommittee. I'll leave it to you what that says about him. I think it makes him pretty special, but that's one person's opinion. The gentleman from Ohio, Mr. LaTourette.

Mr. LATOURETTE. Thank you, Mr. Chairman. Under unanimous consent request, I'll submit my remarks for the record. I would like to say this is the only subcommittee that I requested and Chairman Burton was kind enough to give me additional responsibilities, as well, not requested, but I look forward to serving him.

The reason I picked this subcommittee is not only because of the important work that the Postal Service does and all of the industries and businesses that rely on the Postal Service, but also because of my admiration for you and the ranking member, Mr. Fattah, and the extraordinary work that I witnessed in the last two Congresses on H.R. 22, which is the only time that I've been here. And if you are going to stick it out and get postal reform through the House, the Senate, and signed by the President, I'm going to be here with both of you and we'll all do it together. So I thank you for that.

Mr. MCHUGH. I thank you very much. We're looking forward to your presence. You are an invaluable part of this effort. So with that, again, Mr. Postmaster General, welcome. It is always a pleasure to have you here with us. As I noted, this is our opening salvo for the 106th Congress, and, of course, your first appearance in this new session. So we're looking forward to your comments.

The rules of the full committee, as those who have been to these hearings in the past recall, require that all witnesses be sworn in before they present oral testimony. So with that I'd ask you to rise and repeat after me.

[Witnesses sworn.]

Mr. MCHUGH. Let the record show that the witnesses have responded to the oath in the affirmative. And with that, Mr. Postmaster General, without further adieu let me turn our attention and the floor to you, sir, and welcome.

STATEMENT OF WILLIAM HENDERSON, POSTMASTER GENERAL, ACCOMPANIED BY MARY S. ELCANO, SENIOR VICE PRESIDENT AND GENERAL COUNSEL, U.S. POSTAL SERVICE

Mr. HENDERSON. Thank you, Mr. Chairman, and thank you for the opportunity to testify today. My written testimony I'll submit for the record, as I have in the past, rather than read back to you a speech you've read, which to me seems a bit boring. And I want to introduce Mary Elcano. Mary is our general counsel and she is head of the team that drafted the amendments that we make to H.R. 22.

Mr. MCHUGH. Yes. I welcome you, too, this morning, Ms. Elcano, and look forward to your legal interpretations as they may occur.

Ms. ELCANO. Thank you.

Mr. HENDERSON. For the record, I'm not a lawyer. I do want to make some general comments. I do want to go back about 5 years. We were sitting in a room at Postal Headquarters, and we were debating which of two schools of thought ought to be adopted by the

Postal Service, and that was a debate that was occurring among our Governors too.

Our two schools of thought were, one, to just leave the Postal Service alone, allow it to atrophy, through electronic diversion of competitors, not change anything.

The other one was to say that universal service should be preserved. Universal service is not defined that often, but I think at the core of universal service is regularly scheduled delivery and collection of mail throughout this country so that a mail carrier will go down your street, whether you have one piece of mail or no mail, to check on it. It's hardwired delivery throughout the United States. It's not maximized for profit, it's sitting there to provide service.

In discussing this, we, along with all the posts of the world having the same discussion, decided that the U.S. Postal Service is an American treasure. It's an institution that ought to be preserved. It's vital to this economy. It has a work force of over 700,000, and that stretches to millions of people in this country for employment, millions, along with the industries it supplements.

So out of that came the need to be more commercial, and that need was recognized at the same time around the world. And the Postal Service became more commercial at the same time. What was also happening with the U.S. Postal Service is that its quality was being upgraded. And its quality was becoming very, very competitive, and its quality improved in terms of timely delivery.

It started to affect private sector competitors who, heretofore, had not really focused on the Postal Service because it was not an alternative. Suddenly it became an alternative. So that creates some complexity to this discussion about universal service and about preservation of the Postal Service.

You very wisely introduced a bill for postal reform. In the meantime, posts around the world began to do their own reformation. Suddenly, what had in the past been bureaucratic, kind of slow moving entities, out of that reformation suddenly came highly competitive institutions in countries all over Europe and around the world.

A classic example of that is a reformed German post, Deutsche Post, whose postage is 66 cents, equivalent to our 33 cents, who recently bought a \$1 billion business in England, a logistics company, at a time in which England couldn't invest money like Deutsche Post. I happen to have been with John Roberts, who is the head of Royal Mail, and Klaus Zumwinkel, who is the head of the German Post.

As a result of that investment in England by the German Post, Parliament gave Royal Mail the right, almost immediately, to do similar kinds of investments. And they bought the third largest package delivery outfit, "they" being Royal Mail, in Germany. This commercialization of posts around the world is changing the entire environment.

The United States private sector package delivery outfits, who have been in Europe and around the world for a long time, are suddenly seeing, and rightfully so, these postal entities as being very strong competitors. Very strong competitors. Now, these postal entities around the world are now focused on each other. A little bit

of chest beating is going on in Europe. But within 3 years, I predict they will be focused on the United States.

They are going to be focused because this is the mother lode of market opportunity. They will come over here, they will be private, they will be highly capitalized, and they will be in the marketplace competing. So as a consequence of this, our current U.S. competitors are leery of freeing a postal service commercially. They are leery because of the model they have seen. They have seen postal services around the world become very competitive.

But I say to you today that it's just as important for the Postal Service to be reformed to save universal service. That universal service, regularly scheduled delivery and collection throughout the United States, is just as important today, if not more important than it was 5 years ago. And the forces that you observed 4 years ago in the submission of this legislation, that is the electronic erosion of mail.

Five billion dollars are in the mail stream in the form of payments. Another \$10 billion are associated with those payments. And there is no question that bill payment has some momentum to move electronically. That hardwired infrastructure of universal service would take a big hit from a pricing point of view, if that \$15 billion were allowed to go away without some market improvement, some allowance for the Postal Service to be more competitive.

So when we view H.R. 22, we desperately think that to salvage the organization of the U.S. Postal Service, to keep it viable as an entity in America, that some commercialization of the Postal Service should occur. So we welcomed H.R. 22, and we submitted some 30 amendments, that Mary and her team drafted, to make H.R. 22 as useable as possible, as workable and as manageable as possible so that this entity would stay viable.

It is very important, as it was 5 years ago, to have a healthy U.S. Postal Service. I thank you Mr. Chairman for inviting us, and that concludes my comments.

[The prepared statement of Mr. Henderson follows:]

STATEMENT OF POSTMASTER GENERAL WILLIAM J. HENDERSON
ON H.R. 22
BEFORE THE SUBCOMMITTEE ON THE POSTAL SERVICE
COMMITTEE ON GOVERNMENT REFORM
HOUSE OF REPRESENTATIVES

FEBRUARY 11, 1999

Good morning.

Mr. Chairman, you have entitled H.R. 22 "A bill to modernize the postal laws of the United States." Postal modernization is important for a number of reasons, which I'd like to discuss today. This will underline where the Postal Service is coming from on this legislation, and why we are so serious about pursuing postal reform at this time.

First, the Postal Service matters. That's why all of us in this room are here--

- the nation's largest customer base, and its largest civilian labor force
 - over 765,000 career employees
 - serving all of America, more than 130 million households and businesses daily
 - delivering, on average, 630 million pieces of mail every day
 - about 41 percent of all the mail volume in the world.

America's business -- much of it, obviously -- is in the mails. Our generation of Americans has inherited the best postal system in the world. Mail is a central part of the national infrastructure on which the U.S. economy's global

competitive advantage is based, heading into the twenty-first century -- which leads to the second point:

The new century will absolutely require competitively superior methods and results from postal systems everywhere. This is inevitable. The pace of technology, the globalization of markets, the supremacy of the consumer -- all demand it. Keep up or stand aside -- those are the alternatives in all phases of the economy, including ours.

The more forward-looking postal administrations around the globe are aggressively restructuring. They are getting ready to prove they can perform to private sector, market-driven standards of efficiency and customer service. And still cover their traditional social obligations for universal service, at the same time.

In the United States we have the advantage of the strongest revenue base plus a good start under the structures put in place by the Postal Reorganization Act. We may have the lead in embracing the benefits of technology, and customer-driven methods such as work-sharing. Our challenge is to find the right mix of forward-looking reforms so that twenty-first century postal services will match twenty-first century expectations. We must accomplish this in a manner consistent with the values and traditions of this country.

H.R. 22 is the mark of your efforts, Mr. Chairman, to move the postal community toward an acceptable, modern package of reforms. The diversity of interests involved in postal issues makes it impossible to get the perfect outcome from any of our perspectives. But our common stake in this system bonds us

together in the need to make progress. Even our competitors all depend on regular mail service.

H.R. 22 offers a framework for building a coherent and useful reform package to start the next century. The directions taken in the bill may not be the only way to pursue reform, or the end point where the Postal Service will need to be some years from now. But we think the bill's principle elements can provide a basis for positive, sensible reform.

- A price cap feature, along with baskets, indexing, productivity offsets, and incentive-based compensation, has the potential for improving efficiency and providing our customers more predictability for their postage costs.
- Some modest additional pricing flexibility should increase opportunities for our customers, by improving our responsiveness to market conditions.
- Transparency in the costs and financing of competitive service offerings should provide public reassurance that these services will avoid cross-subsidies and make a reasonable contribution to institutional costs. Our competitors and our customers are entitled to this protection.
- Universal service requirements would be retained, assuring that all of America will continue to have good access to postal services, with some further study and definition.

The bill would radically alter the way the Postal Service has been financed -- in recent years with considerable success. Some say the legislation gives the Postal Service too much: too much freedom, too much flexibility, too much comfort. As I see it, this view misses the point. The object of a price cap is to

eliminate cost-of-service ratemaking. For the first time, there would be no legal guarantee that the Postal Service can meet its costs and pay its bills by raising rates. Financial success will depend on performance. In an economy where high tech now drives advances in productivity, can a labor-intensive delivery service keep up? I think we have to. The concept of the bill adds only some very circumscribed pricing and testing flexibility, to help the Postal Service respond to the market, and where our services are competitive, to allow us to compete fairly.

Why give up a financing structure that still works pretty well? Because like everybody else, the Postal Service has to learn to be more efficient, more nimble, more customer-focused, more market-driven in the years ahead. But before we abandon a ratemaking system that is getting the bills paid, in order to try something more challenging, let's make the new structure as fair and as realistic as we can. A postal system that matters to America depends on it.

Going back to last year, the Postal Service has shared several specific areas of concern where we are convinced progress remains to be made for the core elements of H.R. 22 to fulfill their promise in a workable and realistic form. We have circulated a number of specific amendments for the consideration of the postal community and the Subcommittee.

- The central division of postal services into competitive and noncompetitive categories, and the rules that apply need to be more pragmatic. Pricing structures should be able to reflect the changing demands of the marketplace, while affording protection both for competition and for customers. We would restructure the division of products for more balance. We would accept the

artificial equal cost coverage rule with some clarification, as a starting point for a transitional period.

- During the transitional period the Postal Service would develop, and with approval of the Postal Rate Commission would implement a process for separating the costs, revenues, and financing of competitive products from those of noncompetitive products.
- We can accept the concept of a corporation to provide additional separation for nonpostal activities. This could be a test vehicle for future reforms, provided the corporation has reasonable access to sufficient funding.
- The basket and rate band provisions associated with the price cap for the noncompetitive category should respect traditional protections for particular types of mail. At the same time, drawing on experience in other regulatory systems, the process should promote efficiency through a moderate amount of pricing flexibility around the rates for commercial mail. Negotiated Service Agreements should have workable boundaries so that they will provide incentives for productivity.
- The bill should strike a balance between a reasonable regulatory role for the Postal Regulatory Commission, and an appropriate management role for the Postal Service Board of Directors. We respect the Commission's need for increased authority in some areas, commensurate with its responsibility to monitor proper function of the price cap on the noncompetitive side of the house, and to protect against cross subsidy. For the legislation to deliver the internal incentives for efficiency and productivity which it strives to instill, it must also

assure that the Board has the room to manage the Postal Service and to structure its competitive product offerings.

The Postal Service has sought to engage with all interested parties -- our employees, mail users, competitors, and with the Subcommittee's staff -- to explain our concerns and proposals and to search for common ground. The Postal Reorganization Act has achieved notable success over nearly a 30-year period, by and large, because of the broad consensus that developed around the directions of the reforms undertaken by that Act. A reorientation of the Postal Service to a higher level of expectation in terms of efficiency, market orientation, and competitiveness, will not be comfortable -- as I've said -- or easy. Substantial agreement within the postal community about what should be achieved by reform, and how to go about it, is essential to reach the progress that is needed, in my opinion. While discussions so far have been useful, more remains to be done to reach the level of consensus that seems required.

Mr. Chairman, the Postal Service is committed to see this reform effort through. We will assist the Subcommittee and work with all of the stakeholders in every way we can to complete this work. For the twenty-first century, no less than before, America deserves the best postal services in the world.

Mr. MCHUGH. I thank you for your comments. As those who have read your testimony understand, as I do, you have, I think, a very interesting and very studied perspective on this. But I do think it's important to place a couple of things onto the record and to clarify where possible, and where I certainly think it's necessary.

I've spent, as my grey hair will attest, quite a few years of my adult life in the business of politics in dealing with people writing down your words and reporting them at a later time. I always believe what I read, but I am always willing to learn more than what I've read. But there was a recent article that quoted the following:

Major mailers active in postal reform efforts are beginning to suspect that the Postal Service wants to kill H.R. 22. The mailers point to the latest batch of Postal Service proposed amendments. And when the Senior V.P. of Legislative Affairs told the MTAC meeting, These amendments are "do or die" for the USPS. Well, it had people thinking "die," as in die on the vein—"vein" a little Freudian slip there—"die on the vine."

Some attendants who were confused by the comments followed up with phone calls to Legislative Affairs staffers. That's right, they were told, without the USPS proposed amendments, H.R. 22 is not helpful to the Postal Service, end quote. And it then goes on to point out that not all stakeholders are convinced of this line of reasoning, the debate about the amendments, et cetera.

So I want to make it very clear here today, one way or another, is it your and the Postal Service's intent to kill this effort or are you supportive of this effort as we are currently under way? And, as a part of that, are we to understand that your position is that, without all of the amendments that you have submitted, H.R. 22 is not helpful?

Mr. HENDERSON. Well, let me make sure that there is no ambiguity. We are absolutely, positively not out to kill H.R. 22. And, second, as Chairman Burton said, this is work in progress. We understand that. And just as you wouldn't draw a line in the sand and say "do or die," we absolutely are not going to do that. We've submitted amendments that we think makes the bill manageable from a Postal point of view. But absolutely it's not a do or die situation.

Mr. MCHUGH. Good. The record shall so state. You mentioned the amendments. The amendments, as you are aware, have caused a great deal of controversy. Without trying to read too much into the fact that the vast majority of controversy we have become aware of is in opposition to the amendments, that's not surprising. People rarely call you up and tell you you are doing a good job. They like to tell you just the opposite.

But I'd like to spend a few moments, before I begin to yield to the other members, and having you present, with an opportunity to go onto the record as to why you think some of these amendments are important and in what way they might work. For example, one of your amendments proposes to move just about all products outside the statutory monopoly to the competitive category.

The concern is, to many mailers and policymakers, that the Postal Service, for many of these products and services, is the only hard copy provider. If not in law, certainly in reality. So, in other words, even in the absence of a statutory monopoly, the Postal Service

really does hold what they view to be dominant market power over those customers, newspapers, magazines, those kinds of deliveries, and such.

The bill, as it currently stands, establishes a market dominance, a fact test for the regulatory criteria for assigning products to either non-competitive or competitive. But in your amendments you change that. The question that it presents, and the concerns we've heard, is simply why should the determination of whether the Postal Service product be competitive or non-competitive come from the Service's own regulatory definition of a letter rather than from some objective fact of the marketplace?

Mr. HENDERSON. Go ahead, Mary.

Ms. ELCANO. What our difference in the amendments versus H.R. 22 is that the products we move over from the non-competitive to the competitive are international, heavy First Class Mail, proxy statements, if you will, something like that, and some of the special services. And what's there already is priority mail, express mail, parcels, you know, et cetera. So our view is to move over those products which are positioned where there is competition emerging or constant competition, is consistent with having express mail, priority mail, parcels. The other rationale for that is in reference to the equivalent contribution test that comes into the competitive area, that there is some need to have a balance against that which we consider a very serious and a very strong condition for competition. To move those products over there make it more into a situation where we think the Postal Service can better survive and better compete, as well as meet the obligation for universal service.

Mr. MCHUGH. I understand. I don't have an objection with the intent. Clearly, the outcome of the provisions of H.R. 22 are to make those kinds of determinations. Where they exist, by a formula, a market test, rather, those move over. But concerns of some people are that, and you used international mail being placed in the competitive category, now there is no statutory protection, I'll grant you, of a monopoly for the Postal Service. But I think you'd agree, and if you don't, please say so, that on market dominance there is no alternative for international mail, single mail piece. I mean you're—

Ms. ELCANO. Well, I would have agreed with you up until recently. We recently concluded—are in the process of some litigation with a particular mailer. As part of some discovery in that case, there was evidence that, in fact, they are doing some single piece mail in international. So I think it's not a non-competitive area. It is with competition, in other words, is what I'm saying.

Mr. MCHUGH. Well, you've got a court case trying to determine that, but a single court case. I don't want to argue this ad nauseam but the fact of the matter is, in spite of your recent single example where you've got a court case, the overwhelming evidence is you have a market dominance in that field. But the point being the concern that many have and that is, why should the Postal Service through its own discretion be the determinate factor here? Why not allow the current formula under H.R. 22 to prevail? And you've made your points. If you'd like to expand on them?

Ms. ELCANO. The last piece would be just the general policy overview on that. And that is, to the extent that something is not high-

ly regulated today, we wanted to preserve that status quo and not move it into a more highly regulated area, so we conceptually left international into the competitive area. But I think you've expressed—

Mr. HENDERSON. I might add, Mr. Chairman, from a practical point of view, single piece international is a dying creature. There is a huge amount of erosion in that today electronically. And in a few years that will be a rarity, except for packages, which is highly competitive.

Mr. MCHUGH. So the amendment is a dying amendment, that's my interpretation. These are highly technical, and I want to submit a number of these for the record. I want to ask one more and then I will move to my colleagues. Then if we have some time, perhaps I can ask more questions.

But one of the main objectives of H.R. 22, and one of the main justifications with respect to price capping and banding and dramatically altering the PRC's oversight role with respect to the setting of the price of postage, is to provide predictability to your customers and, also, I would argue, to provide more affordability. Not that you've been unaffordable, but to suggest to them that under this new system you'd be more insulated than you are today from the possibility of large, perhaps unaffordable rate increases. Would you agree with that?

Mr. HENDERSON. Well, the amendments that we propose, where we have bands and baskets, would allow us the kind of balance between flexibility and predictability. And we think that we can live with the amendments, the five baskets versus the four, the adding of the non-profits, and the protections of Aunt Minnie in basket one, we think that we can operate within those. And one of the important principles of that structure is being able to average the rates within the baskets so that you have some flexibility within those bands.

It's one of the difficulties of the bill and what we tried to think through when I discussed with Mary the philosophy of the amendments, is to make sure that we can manage the Postal Service. Make sure that we don't come out with a re-regulated entity that's simply ineffective. And that's a very important principle. And I think you have to use your own management experience in trying to interpret this. It's a difficult task.

It's a very complex bill and your staff has been very cooperative. But it is a very complex subject to try to figure out when it's said and done and the bill is in concrete. You know, will the car still roll?

Mr. MCHUGH. And I appreciate that. Again, we're trying to, ourselves, reach that balance where we provide the Postal Service with our stated objective of the kind of flexibility that you, in all likelihood, need to continue to compete but, as the chairman and others have suggested, at the same time ensuring that you compete fairly where that is possible. And that there are consumer benefits as well.

One of the concerns we've heard with respect to another of the amendments, and you spoke to it, is that under your proposal that you have what you describe as flexibility, but they would describe as a considerable amount of leeway above the stated caps of 1½

percent or more. That, coupled with the fact that you can bring in previously banked, unused cap allowances, takes away that predictability and, they would argue, perhaps that affordability as well.

So it's very troublesome to those people, and I want to be up front about it, it's troublesome to us as well. Because it does diminish, at least, and perhaps for a good reason, and you stated a reason, but nevertheless it does diminish two of the justifications for reconfiguring how you receive your rate increases presently. We're going to need to talk about that further.

Mr. HENDERSON. And I think, Mr. Chairman, pricing flexibility is one of the cornerstone elements that we started with, prices, products and labor. And our having pricing flexibility is very important to our remaining a viable organization. I think we've had a very satisfactory arrangement with the PRC. It has certainly been during my tenure as COO and CEO.

But the ability to negotiate prices with customers or to pass on the values and the NSAs that you provided in the bill, is very important to future Postal health. The foreign postal administrations that come on our soil are going to have commercial freedom, absolute freedom to do whatever they want to do. We at least have to be in the ring with them.

Ms. ELCANO. If I may, Mr. Chairman, the other points you are raising about the caps above the caps. You can imagine when we first started this approach, we had to get some outside consultants to assist us in understanding some of the principles, understand your bill, understand the principles, and craft a response to that. And how they advised us, in terms of telecoms and public utilities, other areas, was that in fact to manage within the baskets, you really needed some flexibility to de-average, and that could even include going above a cap in terms of some of the percentage.

So what we did was to try to design it—and I think that we were advised that in some industries, telecoms, they go up as high as 3 or 4 percent above the cap on occasion. And so what we tried to do was to design a bill that reflected the Postal experience, if you will. So the Aunt Minnie basket, No. 1, has no ability to go above that cap. The more commercial baskets two, three and four have an ability of 1.5 percent. And the fifth basket is 0.5 percent which is the non-profits.

Our view in trying to design that was to pick very tight, tight bands if you will, a tight framework. And within that to try to have a weighted de-average, a weighted average of volume, of revenue weighted averaging within the activities, and take it down to the rate cell, to the rate average piece so that there can be as tight a band, as tight a control on that as possible.

But they convinced us. And it is somewhat of a leap of faith for us because our industry doesn't practice or perform in this area in that way. And so, given the expertise we had, that was also part of the basis for our amendments.

Mr. MCHUGH. I certainly understand how that kind of flexibility would be attractive to a management structure. I have no doubt about that. But I want you and I feel confident you understand that the kind of flexibility that you are speaking about, while

sounding small in percentages is large in terms of the entire structure of the bill.

And it has to always be coupled with whatever bank of previous unused CPI cap you may have used. So, I mean, for mailers, particularly small mail-dependent businesses, this is a very troubling, uncertain part of the waters about which we've heard a great deal of concern.

I may not know much—I will state it differently—I do not know much about utility regulation or deregulation, but with 30 years in politics I know a little bit about PR. I respectfully suggest the last people you want to emanate in the customers' eyes are the utility industries. But do as you will. With that, I will be happy to yield to the ranking member, Mr. Fattah.

Mr. FATTAH. Thank you, Mr. Chairman. I had a visit from the postal leaders from France. And they were here in our country examining the operations of the U.S. Postal Service, which they used as a bench mark from which to try to determine how they could provide better service to the people of their country. Somehow I wished that I had done better in my high school french class. But we had a facilitator that helped us communicate.

There was a recent AP poll that you didn't have to use a foreign language to interpret, and I know there is a lot of interest here in the Capitol these days in not paying attention to polls, but this one said that three-fourths of the American people thought that the Postal Service was doing a very good job.

I use those two comments to really kind of get into this a little bit. And I'm going to try to talk in english so that people can understand what's really going on here, because I think that the chairman is absolutely right that there is room and a reason for reform.

But sometimes the best efforts at reform lead to retarding processes rather than moving them forward. And we have to be careful here since we're dealing with an item, a public good that I think is essential to our economy and is also a responsibility that no one else in this business has, which is this notion of universal service. So I just want to walk through this. The U.S. Postal Service as it is presently constituted doesn't receive any public subsidy for its operation, is that correct?

Mr. HENDERSON. Yes. Except for the blind and frank mail there is no real public subsidy. We live off our revenues, that's absolutely accurate.

Mr. FATTAH. OK. So you've got 700,000-plus employees, you've got a service that you provide, you collect revenues from it that essentially pay for this operation?

Mr. HENDERSON. That's correct.

Mr. FATTAH. But unlike a private concern, you also have some responsibilities that are given to you by the Government, one of which is this notion of universal service?

Mr. HENDERSON. That's correct.

Mr. FATTAH. To deliver mail to anywhere in the country, notwithstanding the economics of it, right?

Mr. HENDERSON. That's right.

Mr. FATTAH. I don't know if it was Ralph Waldo Emerson or someone else who said, "If I make my home in the forest." You

know, if somebody wants to live wherever they want to live, whether they have a better mouse trap or not, you have to deliver the mail to them?

Mr. HENDERSON. That's right. Everywhere, everyone, every day.

Mr. FATTAH. And now in addition to which the Congress has put other limitations on your operation, which is that you can't close a post office because it's not economical.

Mr. HENDERSON. That's in the law, that's right.

Mr. FATTAH. Is that right?

Mr. HENDERSON. That's accurate.

Mr. FATTAH. You can have a post office in one location in which the services that are being sold to the public there are not keeping pace with its cost, but you have to operate it?

Mr. HENDERSON. That's right. The 20,000 smallest post offices of America do not take in enough revenue to cover their expenses, that's accurate.

Mr. FATTAH. OK. So now on the other side of this, there are a few things that you do which there are people in the private sector that do it, and those are what are being discussed as competitive items in this basket, right?

Mr. HENDERSON. There are very few things that we do that don't have some form of competition, be it head to head competitors or alternatives.

Mr. FATTAH. OK. So these services, you have to perform at a rate and at a price which is sensitive to your competition in the marketplace?

Mr. HENDERSON. That's right.

Mr. FATTAH. And this is like the overnight mail and special services that, particularly, business customers are interested in?

Mr. HENDERSON. That's correct. Priority mail is in that category.

Mr. FATTAH. So now when you provide these services to—well, let's start here. If you didn't provide these services and you didn't have the revenues that were generated from those services, the delivery of a First Class letter to an everyday American, would it cost more or less?

Mr. HENDERSON. It would cost more. And there would be no real pricing sensitivity in the marketplace. There would be no not-for-profit product, so all of the products would likely be higher priced than they are today.

Mr. FATTAH. Well, now, as we go forward in this reform, this H.R. 22, here are some things that the Postal Service, that you think are very good about H.R. 22, at least move us in the right direction. There are some amendments that you suggested for modifications. It would be helpful for me if you could outline where you see the major impact of H.R. 22, unamended, for the Postal Service and for its customers.

Mr. HENDERSON. I think that the biggest issue which precedes H.R. 22 is embedded in H.R. 22, and it's what we've submitted amendments for, it's pricing flexibility. If we need that pricing flexibility in order to stay competitive in the marketplace, and that's not a complex notion, and I understand—

Mr. FATTAH. It's not complex for those of us who are fortunately or unfortunately mired down in these issues. But for the general

public, right now what happens when you want to change prices? This issue of flexibility in pricing, can you talk about it in English?

Mr. HENDERSON. Well, today we have two models for setting prices, one in international, in which our Governors can approve a price increase, and the second one is the Postal Rate Commission. As I said earlier, the Postal Rate Commission, during my experience, has been a very responsible body.

What we're interested in, though, is more particular rates for individual mailers, the ability to pass on savings of their efficiency in the mail stream. Now we have one price fits all, or group pricing. And our competitors, direct competitors in the marketplace, have 100 percent pricing freedom. A product like overnight service loses ground primarily because we don't have the pricing flexibility to give volume discounts and things like that. So pricing flexibility is an important point to us.

Mr. FATTAH. Is there something else you'd like to add?

Mr. HENDERSON. No.

Mr. FATTAH. OK. Now, this issue of flexibility in pricing, you are saying it's for your best customers, in terms of volume, that you'd like to be able to negotiate some type of individual pricing mechanism?

Mr. HENDERSON. Right. Well, for all customers. I mean it would be the large volume customers whose efficiency we'd like to pass back to them in terms of pricing.

Mr. FATTAH. Now, at this moment you can't do that at all?

Mr. HENDERSON. We can do it for groups of people, if we go through the Postal Rate Commission. But we can't negotiate face to face, except in international where we do negotiate face to face with customers.

Mr. FATTAH. OK. Now the Postal Rate Commission, which we're going to hear from in a little while, they handle your pricing issues through a regulatory review process, they gather public response to it. How long does that process take?

Mr. HENDERSON. Approximately 10 months and about 6 months in preparation that we do internally to go to the hearing. And they conduct a full hearing with all constituencies. And then they provide a recommendation to our Governors who make a final decision.

Mr. FATTAH. All right. Thank you very much. I'm going to yield.

Mr. MCHUGH. I thank the gentleman. I yield to the chairman of the full committee, Mr. Burton.

Mr. BURTON. Thank you very much, Mr. Chairman. I just have a couple of questions I'd like to ask. First of all, you were talking about the German Postal Service acquiring a private package delivery firm, and that triggered the English, the British, doing the same thing. What I was wondering is you said that you want to be competitive with them so that you don't lose market share because they are going to be coming into the United States, is that correct? I mean, that you want to have a mechanism to be competitive with them?

Mr. HENDERSON. Well, they are here today in the United States.

Mr. BURTON. But they are going to be getting more market share and you want to be able to make sure that you keep your percentage?

Mr. HENDERSON. Well, I think it's that this market in the United States is viewed as the most lucrative in the world.

Mr. BURTON. Right.

Mr. HENDERSON. And, therefore, they will focus on the United States both in shipping letter mail internationally. It is my belief also that eventually they will focus on the package business which not only competes with us but competes with UPS and Federal Express too.

Mr. BURTON. How would you envision the Postal Service being competitive with them, what steps would have to be taken to be competitive with them?

Mr. HENDERSON. I think, again, the real key is pricing freedom, to be able to negotiate with your customers, like an L.L. Bean or Spiegel, the ability to negotiate prices based on their efficiencies. Everybody else in the marketplace, but the U.S. Postal Service, today has complete pricing flexibility.

Mr. BURTON. So in order to be competitive with them you'd like to have the flexibility, so that if you were bidding against them for a contract you could lower your bid and be competitive?

Mr. HENDERSON. That's right. It's like selling. I'll give you an analogy. If you were selling cars, as an example, and you didn't have any pricing flexibility, you would not be the alternative of choice unless you had the highest value and it was obvious to everyone. And that's what you get today with priority mail. I mean, it's a low priced, very high quality product. That's why it's growing.

Mr. BURTON. Well, the next question I'd like to ask then is, how do the private sector carriers, like UPS and Federal Express, and the others in the United States, if you are bidding against the Germans and the English and you are lowering your prices to be competitive, how do they survive? I mean, don't you have the ability as a government entity to be able to cut prices below what their pricing structure would allow?

Mr. HENDERSON. No. I don't believe that to be true. I think the question of the future of those two organizations is an important one. I think that there is a threat that foreign postal administrations, and I believe they believe this, will ultimately be a threat to their existence. When they come into this country as, for example, the Dutch have and bought MailCom, a major interest in MailCom, they come with very deep pockets. And it is an important question that you raised.

Mr. BURTON. I think that's something we really ought to take a look at because they're competitors with the private sector in this country, and then you are going to add to that through postal reform I think you hope, your ability to be competitive with those foreign entities, which puts additional pressure on the private carriers in this country.

A lot of us believe that free enterprise is the best way for an economy to flourish. And if the government sector comes in and is able to drive the private sector out of business, then you end up with government control over large segments of your economy, not just the Postal Service but others.

So I'm just trying to figure out in my own mind how this is going to work in the long haul, and that's why I'm asking this question.

Maybe you can flesh this out for me in the next few weeks by giving me more information. I'm not sure I'm going to get it all today.

Mr. HENDERSON. I can give you a twist on it today. The private sector is primarily focused on business-to-business packages, that's the dominance. If you look at residential, they surcharge residential by adding \$1, and in some cases \$2, in some cases delivery every 4 days. The Postal Service doesn't have any of that business, literally speaking. It's focused on residential package delivery. So, in a sense, they are not in the same arenas.

And if we're taken out of that business, if we're not in the business of package delivery, for example, then you have to take several billion dollars and amortize it across the rest of the classes of mail. And, to me, that doesn't seem to be in the interests of the American public to do something like that.

Mr. BURTON. I understand the example that you were using, Mr. Postmaster, just a few minutes ago, was one of the mail order delivery systems companies. I think you mentioned Lands' End?

Mr. HENDERSON. L.L. Bean, yes.

Mr. BURTON. Yes, L.L. Bean. And that is one that I think the private sector has been, for the most part, delivering for. And so that's a concern. And I think maybe you can have your staff and you illuminate that issue a little bit more for me in the next few weeks. I think it's something that we really need to take a look at.

The other thing I was interested in was how this new formula for postal rate increases works. And I was asking the staff up here, when the chairman yielded to me. I really would like to know how that works because I think maybe I'm wrong. I was trying to catch all of what you said there a minute ago. I thought you said that if you weren't able to deliver the packages, and do your package deliveries and the things that you've been doing, that the postal rates for other classes of mail, like First Class Mail, might go up?

Mr. HENDERSON. That's accurate.

Mr. BURTON. That is accurate. OK. I just have a couple of questions and they may be very academic questions. The Postal Service for the last 2 or 3 years has had a fairly substantial profit. It was about \$1½ to \$2 billion 3 years ago, and about \$1½ billion last year. I think it was about \$580 million just this current past year. And yet they had a 1 cent per stamp delivery increase from 32 to 33 cents, and I could never figure that out.

If, in effect, the package delivery is helping make the First Class Mail rates less, then how do you account for that profit. I just don't understand that. Maybe you can explain that to me?

Mr. HENDERSON. Well, the Postal Service enjoys, unfortunately, a negative net equity, which means that we've lost more money than we've made since 1971. And, obviously, we have a break-even mandate. Additionally, we have some new capital expenditures, such as our new point-of-sale system. We also have a \$700 million delivery confirmation effort that we are putting in place.

We are trying to upgrade the service of the Postal Service, and the 1 cent was the smallest increase in our history. In fact our popularity with our customers, for the first time in our history, actually went up. And so we don't think it's a burden on America to increase the price of postage.

Mr. BURTON. I know. I was just questioning the necessity for the rate increase since they've been in the black for 3 straight years. And I think you amortize the things that you are talking about over, what, about a 10 year period, or something like that?

Mr. HENDERSON. The \$700 million is the outlay that we made to buy the scanners, so it's not depreciated over a period of time.

Mr. BURTON. OK. I guess that's about all I need to ask about right now, other than I'd still like to see that formula on how you are going to increase the rates for First Class Mail and, I guess, bulk mail and other mail. If the electronic mail takes a larger and larger part of your volume, let's say your volume goes down by 25 percent, does the formula include that being factored into the new rates?

Mr. HENDERSON. Sure. If you lose revenue, and to some degree much of our infrastructure is hardwired because of our universal service obligation, and you have a break-even mandate, you have to generate those revenues from some other source.

Mr. BURTON. So that's why you think the package delivery is very instrumental because if you lose market share in, say, First Class Mail because of electronic transmissions then you're going to try to pick that up through the package deliveries and others?

Mr. HENDERSON. We think package delivery is important because we're the residential deliverer in America. We're the person that goes by your house every day, by your mailbox.

Mr. BURTON. I understand. But you are anticipating that if you lose market share in, say, First Class Mail that you are going to try to pick that up through the delivery of the packages?

Mr. HENDERSON. Well, we're going to try to grow, literally, all aspects of our business, but you are accurate in that statement.

Mr. BURTON. And one last question and then I'll thank the chairman. How much money did Postal Service pay in advertising for package deliveries last year? Because I see that on TV all the time, and I just wondered—

Mr. HENDERSON. I don't have that number off the top of my head but I'll be happy to provide it.

Mr. BURTON. Somebody told me it was around \$230-some million.

Mr. HENDERSON. Not for packages alone, no. No.

Mr. BURTON. I'd really like to have that figure. If we could get that, Mr. Postmaster, I'd really appreciate it. Thank you very much. Thank you, Mr. Chairman.

[The information referred to follows:]

DEBORAH K. WILHITE
SENIOR VICE PRESIDENT, GOVERNMENT RELATIONS



February 23, 1999

Honorable Dan Burton
Chairman
Committee on Government Reform
House of Representatives
Washington, DC 20515-6143

Dear Mr. Chairman:

This is in response to your request for information concerning the Postal Service's advertising budget.

The attached chart breaks down the Postal Service's advertising costs by product and service. Please be aware that this information, which could be of potential benefit to persons or firms in economic competition with the Postal Service, is considered proprietary information. As such, it is being released to you in your capacity as Chairman, Committee on Government Reform.

I trust this information responds to your concerns. Please let me know if I may be of further assistance.


Deborah K. Wilhite

Attachment

475 L'ENFANT PLAZA SW
WASHINGTON DC 20260-3500
202-268-2506
FAX: 202-268-2503

Mr. MCHUGH. Mi casa, su casa, Mr. Chairman. I think the chairman's original first question brings up a good point, it kind of goes to the issue of another of your amendments. As the chairman stated, certainly the Postal Service does enjoy the powers of a Government agency, along with the statutory monopoly that you have with respect to delivery mail.

One of the concerns that we've been trying to meet, and one of the objections we've persistently tried to overcome, is that you should not compete, as I think the chairman was suggesting very clearly, with private companies while you use, particularly, your non-competitive products to pay for the overhead costs, unfairly pay. So the issue of how do we end cross subsidies has been an integral part of the debate, as I know you are aware.

H.R. 22 attempts to do that through the cost coverage rule which, as you know, Mr. Postmaster General, is simply the requirement that the competitive products collectively must contribute as a group at least an equal percentage of overhead costs as all non-competitive and competitive products combined.

There is no way, it seems to me, we're going to be able to solve the chicken or the egg debate that apparently has been going on in this industry for years, where one side says you cross subsidize and the other side says, no we don't. So what we have been attempting to do is not solve the debate, but to settle the argument for the future through that cost coverage rule.

And yet, you, in one of your amendments, have suggested that cost coverage rule be sunsetted after 5 years. And I believe your contention—and if I'm misstating it, please correct me—but I believe your contention was that there are sufficient safeguards elsewhere in H.R. 22 to prevent cross subsidies so that the cost coverage rule is "problematic," the word I believe your descriptive materials use.

So I'd like to have you expand upon that, because, as you've heard from the chairman and I know you've heard, as we have, from others, the issue of the activity of cross subsidies is a very, very important one, and one that the cost coverage rule is intended solely to address. If you sunset that after 5 years, the resulting concern is that, well, there they go again. So could you comment on that amendment and on the issue in general?

Mr. HENDERSON. Sure. First, let me say we are sensitive to cross subsidies. Today in America, urban America subsidizes rural America because it's very inefficient to deliver in rural areas. So there is a built in kind of hand shake within the institution of the organization.

What we're sunsetting after 5 years is the equal contribution, not the issue of cross subsidy. The competitive and non-competitive have to have an equal contribution. What we're saying is that after 5 years we think that issue will go by the wayside. But we're not trying to hide some cross subsidy in the bill.

Mr. MCHUGH. I'm not sure why you think it will go by the wayside after 5 years.

Mr. HENDERSON. I think the organization will be fairly well defined. Once the process is put in place to define the costs, which we proposed in one of our amendments, because today we operate under a set of institutional attributable costs that go into deter-

mining a rate case, we assume that that whole assignment of a cost is going to be examined.

We will cooperate with the Postal Rate Commission in putting the process together to examine those costs. We will then hardwire what our costs are, and there won't be a question anymore of attributable institutional costs. We will design that system.

Ms. ELCANO. The other safeguard, if you will, is that there is currently in H.R. 22 a requirement that those products cover their attributable costs. And in our amendments we accept that and understand the rationale for that, and so those are covered. Those are reported to the Rate Commission. That's the other safeguard that exists in the bill.

Mr. MCHUGH. Well, again, the amendment, it seems to me, becomes more problematic than the problem you are trying to solve, in that the cost coverage rule, as I've said repeatedly, is intended to forestall a debate that has raged here and that seems to me has no conclusion in terms of proving who is right and who is wrong.

So you institute a system that better defines the issue, No. 1 and then, No. 2, requires that certain accounting things occur without the assumption that the system will change or what you and the PRC may or may not agree to. There are, apparently, a lot of things that are embodied in a number of your amendments that are making assumptions as to what may or may not exist a few years down the road.

Now, I'm not saying you're wrong in those assumptions, but those who are relying upon the service and upon the system that we adapt to provide for them the kind of mail service they are accustomed to and need, those kinds of assumptions are very troubling.

Ms. ELCANO. There are a couple of other points and, again, it's in the eye of the beholder. As I behold it, it would look like this. There is an acceptance in the competitive area that they would be covered by anti-trust and anti-competitive statutes, and so there would begin to be some other analysis and other forums to address that.

The other thing we're concerned about, why that 5 year rule is in there, that 5 year sunset, is that some of the best information that we can get, and different conversations with different experts, is that maybe some of the bill payment activity that would go into e-commerce, the bill presentment might have a 3 to 5 year horizon.

So to the extent that that begins to crush down in the non-competitive side, there may well be changes in prices in the non-competitive side that then become an anchor on the competitive and drag it down in terms of pricing to the extent the equal contribution stays. And so, again, from our view of this, the equal contribution is not really fixing or defining cross subsidy at that point. It's a price definition, it's a control on pricing in the competitive area that's different from being market driven, market based.

While we understand that there needs to be a transition, we thought a 5-year time period was reasonable for things to begin to settle out in terms of the e-commerce issue, in terms of setting up systems that extend better financial accounting, better evaluation of assets and liabilities, as well as some of the more specific product pricing that would go on in competitive being market driven.

The other view is that as you define H.R. 22 the competitive products would need to be funded eventually, not by the Federal Financing Board, you know, not the Department of Treasury, but eventually from the private markets. The view of the world from the private, financial advisors tell us that you need to have a system in place where it's very clear who is funding what, who is borrowing what, and who is paying something back.

And so, again, from our vantage point, putting all those factors together, we thought a 5-year sunset lets the bill take its new shape, lets the Postal Service adapt, addresses the cross subsidy through the anti-trust, the attributable cost tests, which we would be reporting to the Postal Rate Commission, and begins to put the Postal Service in a position that if, in fact, there is a big drop off in that protected non-competitive area, that it doesn't drag down the other part of the competitive.

Mr. MCHUGH. Well, again, from a managerial perspective, I don't fault the Postal Service for wanting to have a bill here that provides them flexibility on the future as they may see it. But, as I know you understand, not everyone shares that same set of assumptions or sees that same vision.

Ms. ELCANO. That's right.

Mr. MCHUGH. So you are suggesting, I take it, that, if there was a cross subsidy, that would be a violation of an anti-trust law?

Ms. ELCANO. I'm not sure that that would be the violation of the anti-trust law. I think that what I'm saying is that we would be subject to anti-trust laws. We understand that products have to cover their attributable costs and that this is structured in a way—I have zero experience in anti-trust law so I'd like to either reserve an answer on that or just tell you that we understand we'll be covered by anti-trust law.

Mr. MCHUGH. OK. Well, you used that as an example of preventing cross subsidies so I thought you were making a statement. But I'm no expert either, that's why I asked the question. Let me move onto a final point, a final concern.

As you may be aware, if you are not, and others in the room you probably will soon be, there have been a number of concerns raised with respect to so-called "Title 39 provisions," the current postal laws that apply to the mailing of obscene and pornographic materials.

When we were first formulating this bill some 3 years ago, as we did in a number of law enforcement areas, we went to the Inspection Service and others and said, "Is there anything, while we're at this activity of reform, that you might like to see enacted that would make the job easier or more effective, et cetera?"

One of the things that the Inspection Service gave us was language on how to redefine, in their opinion, more precisely the current Title 39 provisions with respect to pornographic materials through the mails, unsolicited. We were told that the language that they presented would enhance their ability to pursue those kinds of potential violators and ultimately to prosecute them. That language has stood virtually unchanged in every version of H.R. 22 for the last 3 years.

Recently a particular individual, but purportedly representing a wider universe of individuals, has raised an alarm, saying, amongst

other things, that the purpose of this redesignation of Title 39 is to end effective enforcement over the mailing of pornographic materials—that the change would result in fewer, not more prosecutions, that it would subject recipients of mail to all kinds of unsolicited pornographic materials.

This is kind of off-the-beaten path with respect to Title 39, but clearly something I am concerned about. When we are given language by the Inspection Service, purportedly to toughen pornographic mailing penalties, and there is even the slightest suggestion that we are going in the opposite direction and that, as well, there may be some hidden agenda as to why we are doing it, is disturbing to me.

This is not something I would expect you to respond to in detail today, although if you could, I would appreciate it. But, at a minimum, I would request on the record that you look at the language of Title 39, perhaps discuss it with the Inspection Service, to ensure that the language is as you and the Inspection Service wish it, and get back to us. And I'd certainly appreciate it, if you have any comments.

Ms. ELCANO. Just the main comment is you are absolutely right. There is no intention to weaken that statute or enforcement of that statute on behalf of the Postal Service. That we want to strengthen it, not weaken it.

Mr. HENDERSON. We will provide you with a response.

Mr. MCHUGH. I appreciate that. I yield to the ranking member, Mr. Fattah.

Mr. FATTAH. I think it's abundantly clear that there is significant and sincere interest in the economic circumstances of UPS and Federal Express. These are companies that I think you know complement the economic activity in our country in a very significant way.

They were established and conduct themselves in the business arena where they've made the decisions to get into this business with the full knowledge of the operations of the U.S. Postal Service. I mean, the U.S. Postal Service didn't show up yesterday nor did Federal Express or UPS.

I think it's very important, as we go forward here, that we not do permanent damage to the mandate given to the Postal Service and its opportunity to meet its mandate with some ill fated attempt to assist the private sector when the private sector is quite capable of assisting itself in many respects. And I won't bore you with the details of this, but I just think we need to be careful as we go forward.

It's very important here, given what you've said, and I think you're right, that there are going to be more significant activities from international competitors in this marketplace. And the whole issue of both attributable costs, and cost coverage, and the like, we need to, speaking in English, have people understand what it is that we're talking about.

The first issue here is that we have taxpayers in this country who today receive First Class Mail for 33 cents and in most cases, 90 percent or better, 1 day after it's put in the mail box, it's delivered. And to the degree that we make any of these changes, it needs to be clear to people what impact it's going to have on that

service, which is principally the service that most people are involved in in terms of the U.S. Postal Service. Is it going to cost them more, and is the letter that they receive going to be received in the same level of efficiency it is received now?

And then, as we move beyond that, you know, questions about how the Postal Service interacts in the marketplace both among your private sector competitors and now questions in terms of international competition. So I want to thank you for your comments today, but, obviously, we're going to have a lot of work to do as we go forward. It is of interest and of note that the U.S. Postal Service has these statutory burdens, that we talked about earlier, but also has, I think, a responsibility to try to within reason meet the terms of economic competition from those who decide to compete with you.

I think there is a difference between those that decide to compete with you and those you decide at some later date to then get in competition with in the private sector. And I think that is a distinction to be drawn there as we go forward in this work. So, thank you.

Mr. MCHUGH. I thank the gentleman. Before I call for the second panel, I had been handed a note that Chairman Burton had to go on to another meeting. We appreciate his spending such a significant amount of time with us.

But he wanted to clarify his request, Mr. Henderson, with respect to the advertising costs. He wanted to make it clear that he'd like the detail by product. In other words, I assume, as much a line item by item breakdown as you could, rather than just a lump sum advertising budget.

Mr. HENDERSON. We'll provide that.

Mr. MCHUGH. Thank you. With that, we do have a substantial number of questions, as I'm sure you understand and as is the rule, to present to you for the record. As you have done in the past, we would appreciate your consideration of those and respond by providing us with that material as well.

Again, Postmaster General William Henderson, General Counsel Mary Elcano, we thank you for being here this morning and, based on your response to my very first question, I'm looking forward to working with you further on H.R. 22.

Mr. HENDERSON. Thank you, Chairman McHugh. And I'm going to be leaving, I have a commitment. It's not out of lack of interest in what the other witnesses say, but I do have a commitment out of the country this evening. So "Adios" is not being uninterested. Thank you.

Mr. MCHUGH. Well, we understand. Have a safe journey and come back to us soon. Thank you.

[Additional questions for Postmaster General William J. Henderson and responses follow:]

QUESTIONS SUBMITTED TO POSTMASTER GENERAL WILLIAM J. HENDERSON
IN FOLLOW-UP TO THE HEARING ON
H. R. 22, THE POSTAL MODERNIZATION ACT OF 1999

Question 1:

The PRC has testified that the Postal Service's package of amendments to the ratesetting process would: (1) eliminate those provisions that would provide an impetus for improved productivity and lower rates, (2) eliminate those provisions assuring that the benefits of improved productivity would be enjoyed by all mailers fairly, and (3) modify standards so that bonuses would almost certainly be available even if the Service became less productive. The PRC claims that amendments of this nature subvert the purpose of postal modernization and reform legislation, and should be rejected.

The PRC set out in testimony what it considers to be the bedrock principles of postal reform. In brief, those principles are: (i) the Postal Service should remain a basic and fundamental service provided to the people by the Government of the United States, and as such, it should be operated in a fair and nondiscriminatory manner, (ii) if the Postal Service can be operated more efficiently, rates will not increase as fast as they would otherwise to the benefit of all stakeholders, and (iii) competition between the Postal Service and private enterprises should be as fair as possible.

Please respond to the PRC's concern and discuss how the Postal Service's proposed amendments would, in its view, further the cause of postal reform to the benefit of the all stakeholders.

Response:

In his February 11, 1999 testimony before the Subcommittee on the Postal Service, Postal Rate Commission Chairman Edward J. Gleiman testified that the "bedrock principles of H. R. 22" are:

... first and foremost ... that the Postal Service remains a basic and fundamental service provided to the people by the Government of the United States, and as such, it should be operated in a fair and nondiscriminatory manner. Mailers, suppliers, competitors, and other interested citizens should have assurances that the Service will perform its functions consistent with the policies set forth in Title 39.

The second principle contains two interrelated parts. If the Postal Service can be operated more efficiently, rates will not increase as fast as they would otherwise, and this will benefit both mailers and the nation as a whole; and, management and labor are most likely to operate more efficiently if they can receive personal, financial rewards, in the form of bonuses, for doing so.

A third principle is that competition between the Postal Service and private enterprises should be as fair as possible. In colloquial terms: competition should take place on a level playing field. H.R. 22 contains numerous provisions designed to level the competitive playing field.¹

The Postal Service agrees that the principles enumerated by Chairman Gleiman are, and should be, the guiding principles underlying any postal reform legislation. However, we disagree with Chairman Gleiman's conclusion:

¹ "Testimony of The Honorable Edward J. Gleiman, Chairman, on behalf of the Postal Rate Commission Before the U. S. House of Representatives, Committee on Government Reform, Subcommittee on the Postal Service," February 11, 1999, pg. 3.

... that the Postal Service amendments are directly contrary to the bedrock principles of H. R. 22. [And] ... would ... erase many of the checks, and decalibrate many of the balances, that have been ... incorporated into the bill ... ²

The Postal Service proposed amendments to H. R. 22 with the goal of building on the aspects of the bill that we believe further our shared goal of adapting the Postal Service to changing market conditions. Our proposed amendments offer concrete proposals designed to:

- Clarify certain provisions of H. R. 22;
- Increase pricing flexibility relative to the very limited flexibility offered by H. R. 22, and as a result, better protect customers; and,
- Provide more workable cost tests.

The Postal Service has not eliminated those provisions that would provide an impetus for improved productivity and lower rates. We recognize the importance of a financial incentive to encourage improved productivity within the Postal Service; however, the presumption of a negative X-factor included in §3733 of H. R. 22 does not recognize the realities of the Postal Service's cost structure. Almost 80 percent of the Postal Service's costs are associated with labor, and most of these costs are subject to collective bargaining agreements. Accordingly, the Postal Service does not have the same opportunities for productivity gains experienced by more capital-intensive firms.

Economy-wide productivity growth is imbedded in the Consumer Price Index (CPI) and adjusting this by an additional productivity offset or X-factor would "double count" productivity growth. On average, the Postal Service's productivity growth has been close to that of the economy as a whole. If the productivity of the Postal Service exceeds that of the economy as a whole, the Postal Service's proposal allows a negative adjustment factor to be established.

The Postal Service's amendments do not eliminate those provisions that assure that all mailers will enjoy the benefits of improved productivity fairly. The proposed rate caps for the five baskets in combination with rate bands imposed on individual rates are designed to produce rates that are fair and equitable for all mailers.

While the rate cap limits the average price increase for any basket to CPI - X, the rate bands limit the change in any specific price. Under the Postal Service's rate band proposal, any rate's price change must be within a specified band around the percentage change in the rate cap. Many mailers use relatively few rate cells, and therefore, could be adversely affected by a significant change in one rate. Recognizing this, the Postal Service proposes using rate bands to limit the change in any rate cell, thereby eliminating the possibility that the averaging inherent in rate bands could mask large price changes for individual rate cells, thus inadvertently hurting specific mailers. In addition, the rate bands are designed to provide added protection for customers in Basket 1 (the Aunt Minnie basket) and Basket 5 (nonprofits). No rate in Basket 1 can increase by more than the rate cap (CPI - X), and, in recognition of the unique characteristics of nonprofit mail, the maximum rate increase for Basket 5 is limited to 0.5 percent above the rate cap. The Postal Service is responding to industry concerns that nonprofits' rate increases (if any) be comparable to those for the equivalent commercial category.

The increased flexibility under the Postal Service's proposed rate bands will benefit mailers by breaking the link in H. R. 22 between the rate changes allowed for different products. Under H. R. 22 as proposed, all rates must move within a four-percentage point band regardless of the underlying cost relationships.³ If, for example, the costs for a single (small) class of mail increased dramatically due to the unique operational characteristics of that class, the Postal Service may be required to increase all postal rates, even if the underlying costs for the rest of the

² Ibid.

³ U. S. House of Representatives, Committee on Government Reform and Oversight, Subcommittee on the Postal Service, John M. McHugh, Chairman, "Section-by-Section Analysis H. R. 22: Amendment in the Nature of a Substitute," August 24, 1998.

mail stream decrease. Under this scenario, many mailers could not realize the benefits of improved productivity because of the statutory link between rate changes across mail classes.

The Postal Service's amendments do not "modify standards so that bonuses would almost certainly be available." Under the provisions of §3773(f)(2)(B) of H. R. 22, "the sole source of funding shall be any profits from any year." The profitability of the Postal Service depends on the efficient management of the Postal Service's resources. Increased productivity may result in profits; H. R. 22 recognized this in establishing the bonus system. However, by giving up the right to file omnibus rate cases incorporating rate changes greater than those allowed under the Postal Service's pricing proposals, the Postal Service will be required to manage its resources more effectively in order to simply break-even. This will result in an increased level of productivity and if Postal Service management is very successful, may result in a small profit.

Question 2

The Postal Service proposes to move almost all products outside the statutory monopoly to the competitive category. Of concern to many mailers and policymakers is that the Postal Service – for many of these products and services – is the only hard copy provider. In other words, even in the absence of a statutory monopoly, the Postal Service holds dominant "market power" over certain customers, such as delivery of letters, newspapers, and magazines.

H.R. 22 establishes a market dominance fact test as the regulatory criteria for assigning products to the noncompetitive or the competitive category. This is the same test that the Federal Communications Commission used in overseeing AT&T; as genuine competition developed for certain services, they were afforded greater commercial freedom and less regulatory oversight. AT&T did not "self determine" what was deemed competitive.

Why should the determination of whether a Postal Service product is competitive be based on the Service's own regulatory definition of a letter, rather than the objective facts of the marketplace?

What weight has the Postal Service given to the fact that H.R. 22 does not eliminate the mail box monopoly in defining what products are noncompetitive?

Response:

The Postal Service does not propose "to move almost all products outside the statutory monopoly to the competitive category," and has attempted to divide its products and services between the noncompetitive and the competitive categories based on the degree of competition within the relative market. In addition, our proposed classification of products between the noncompetitive and competitive categories is very similar to that included in the current H. R. 22.

In addition, the Postal Service has not determined whether a product is competitive based on its own regulatory definition of a "letter." Rather, the Postal Service has accepted the limitation of the statutory monopoly proposed by H. R. 22 (the "six-times" First-Class, first ounce rate rule), and expects that this change would result in increased competition for heavy-weight (over eight ounce) First-Class Mail by eliminating the content-based definition of a "letter" for these pieces imposed by the current Private Express Statute. Also, all current suspensions of the Private Express Statutes are "grandfathered" and any First-Class Mail meeting the requirements of these suspensions is considered to be in the competitive category. The Postal Service does not envision the Private Express Statutes applying to any mail in the competitive category. In addition, a substantial amount of mail in the noncompetitive category is not subject to the Private Express Statutes.

No significant alternative delivery exists for Periodicals, Nonprofit Mail, or Standard (A) Mail; therefore, these classes are categorized as noncompetitive. Today, significant competition exists for Priority Mail, Express Mail, Mailgrams, international mail, and Parcel Post; therefore, these products are appropriately included in the competitive category. Special Services were assigned to the noncompetitive or competitive category based on the degree of competition they face in the market place or their close association with a competitive product. For example, post office boxes in fee groups A, B, and C are typically located in cities of sufficient size that alternate providers such as Commercial Mail Receiving Agencies (CMRA) exist.

Within the Standard (B) parcel classification, only bulk parcel post would be classified as competitive. Individual parcel post, along with Standard (B) special rate (books, etc.), bound printed matter and library rate matter would be placed in noncompetitive categories. This amounts to almost 87 percent of all Standard (B) surface parcels. In fact, much of the content of these classifications, which include books delivered in bulk to commercial establishments are well beyond the Private Express Statutes definition of a letter. However, the Postal Service included these classifications in the noncompetitive category, in part, to recognize either their importance to individual mailers (single piece parcel post) or their traditional status as a preferred rate category (library rate). Effectively, the Postal Service is restricting its pricing flexibility by agreeing to conform to the noncompetitive pricing rules even though significant competition exists for some segments of this market.

The Postal Service is not "self-determining" which products are deemed to be competitive. We have interpreted Chairman McHugh's characterization of the H. R. 22 process as a "benchmark for further discussions"⁴ as an invitation to discuss the assumptions underlying H. R. 22 and to present alternate views when the Postal Service felt clarification or revisions were necessary. Ultimately, if H. R. 22 is enacted, it will codify the initial definition of competitive products.

The Postal Service has not considered the mailbox monopoly in defining which products are noncompetitive. Instead, it has looked at the competitive conditions in the market for postal products and evaluated whether postal competition actually exists for a given product. However, the Postal Service believes that the American public's trust in the security of the mails and in the Postal Service as the deliverer of personal correspondence and financial records requires the maintenance of the mailbox monopoly. The ability to protect the sanctity of the mail from the point of deposit to delivery is based in part upon the ability to manage the point of delivery or the mailbox.

Question 3

To illustrate the previous question, H.R. 22 places, among other services, the following items in the Aunt Minnie basket of noncompetitive products: international first-class letters, international first-class cards, and international parcels. These are the only international postal products placed in the noncompetitive category; all the rest are deemed competitive under the bill.

Under the Postal Service proposed amendments, all of international mail would be placed in the competitive category, including the aforementioned Aunt Minnie international products. However, there is effectively no alternative for sending single piece international letters, cards, and parcels in today's market. Based on market dominance considerations alone, it is reasonable that these categories be treated as noncompetitive and that the captive customer be given some protection through the price cap until such time as it meets the FCC test.

What is the Service's justification for eliminating the protections afforded the single-piece (a.k.a. - Aunt Minnie) international customer under HR. 22?

⁴ Statement of the Honorable John M. McHugh, Chairman, Subcommittee on the Postal Service, H.R. 22 Markup – September 24, 1998.

International mail is not technically covered by the statutory monopoly. The Postmaster General and the General Counsel implied that it also doesn't dominate the single-piece international market for Aunt Minnie by referring to a court proceeding that included information that a particular mailer was "doing some single piece in international". Please provide all evidence, including the details of the referenced case, for the record to support your proposal to move single piece international mail into the competitive category.

Response:

All single piece international mail rates; namely, letters, cards, and parcels serve a combined constituency consisting of both single piece users and customers posting multiple pieces at single piece rates. Open competition has applied to all categories of outbound international mail for both groups of customers since 1986 with the level of competition rising significantly over the past three years. The presumption that including single piece international mail in the competitive category would hurt Aunt Minnie is in direct conflict with the observed effect of competition on rates since 1986. Single piece international rates are lower today, and therefore, Aunt Minnie is better off, than she would have been had international mail not be subject to open competition.

Prior to 1986, Air Letters, for example, were priced at twice the domestic First-Class rate at the first weight step, and were additionally burdened with absorbing the cost of inbound foreign origin mail. As a result, Air Letters were not only cross-subsidizing foreign inbound traffic, but were being priced as a function of domestic letters. Had this regime remained in force, current international letter rates would be higher than they are today. In essence, competition has benefited the users of single piece letters as evidenced by the table below. The Postal Service has an 11 year history of pricing single piece international mail to Aunt Minnie's advantage.

Letter Rate Histories						
	<u>1981</u>	<u>1985</u>	<u>1988</u>	<u>1991</u>	<u>1995</u>	<u>1999</u>
	Year of Rate Change					
Domestic	20	22	25	29	32	33
<u>International</u>						
-Actual	40	44	45	50	60	60
-Pre-'88 Regime	40	44	50	58	64	66

All international mail is subject to competition, including single-piece letters. The market limits the rates that can be charged. We see this in the consistent pattern of declining volumes of international air letters. In a suit brought by a remailer against the Postal Service which settled in 1998 before trial, the plaintiff took a position consistent with the claim that it competed with the Postal Service's international single-piece Global Priority Mail delivery. In that case, the plaintiff asserted that the Postal Service's trademark infringed its own mark. Competition is an important factor in determining trademark infringement and thus was an important aspect of the plaintiff's case. In depositions of the plaintiff's officers, the plaintiff presented evidence supporting its competition with Postal Service's international single piece delivery. These depositions were destroyed pursuant to a protective order for confidential information that the parties entered into before discovery, and are therefore unavailable.

Question 4

The Postal Service proposes an amendment that reserves to the Postal Service the right to initiate transfers between noncompetitive and competitive categories. In explaining this proposal the Postal Service contends that this will insulate it from efforts by competitors or other parties to move high- or low- performing products from one category to another.

If the Postal Service's amendment to prohibit transfer of product from the competitive to the noncompetitive category was adopted, wouldn't this lessen the need for this amendment?

Response:

The question misinterprets the Postal Service's proposed Amendment 4: Concerning Transfer of Products between Categories. Although this amendment does eliminate transfers of products from the competitive to the noncompetitive category, it does not reserve to the Postal Service the right to initiate transfers between the noncompetitive and competitive categories. The Postal Service's proposed amendment states:

Upon request of the Postal Service or users of the mails, or upon its own initiative, the Postal Regulatory Commission may . . . transfer one or more products from the noncompetitive category of mail to the competitive category of mail. [emphasis added]

The Postal Service proposed this amendment to (1) insulate itself from efforts to move desirable products -- for which a competitive market has already been determined to exist -- from the competitive category of mail to the noncompetitive category of mail where additional pricing restrictions are imposed, and (2) recognize that, as markets evolve, the competition facing products in the noncompetitive category may increase to the point where a product transfer from the noncompetitive to the competitive category is appropriate.

Question 5

The Postal Service proposes moving COD, insurance, delivery confirmation, and merchandise return into the competitive category. It has been suggested that these special services be treated as competitive only to the extent that they are offered in conjunction with other competitive products.

Does the Postal Service agree with this suggestion?

Response:

One of the criteria used in the Postal Service's assignment of COD, insurance, delivery confirmation and merchandise return service to the competitive category was the existence of competitive alternatives for these products. One indication of the degree of competition for these products is the extent these services are provided in conjunction with competitive products. However, that is not the only indication of the degree of competition. For example, insurance can be purchased with light-weight First-Class Mail pieces included in the noncompetitive category; however that does not imply that insurance for these pieces is a noncompetitive product. Customers have alternatives to Postal insurance for items mailed using First-Class Mail. The existence of these alternatives rather than the mail class used is the appropriate determinant of whether a special service product should be assigned to the noncompetitive or the competitive category.

Question 6

The Postal Service also proposed to move post office box and caller service (fee groups A, B and C) to the competitive category. With regard to post office boxes and caller service, concern has been raised that the Postal Service might be tempted to provide priority pickup of incoming mail for its services over the pick up of incoming mail by private post office service providers.

How might the Postal Service address this concern?

Response:

The question makes at least two assumptions that may not be totally valid. It assumes that the Postal Service not only has the ability to track mail for these third-party box services during the incoming sorting and delivery process, but that it also can easily and selectively defer and store their incoming mail. In fact, efficient, timely delivery hinges upon the consistent processing of all mail. Private post office services often act as partners to the Postal Service in providing postal services to their customers.

The Postal Service does not and will not offer preferential treatment for incoming mail for Postal Service post office boxes and caller service over incoming mail for other third-party mail box services. If H. R. 22 is enacted, any alleged discriminatory treatment of Postal Service competitive services could be resolved through the complaint procedure before the Postal Regulatory Commission.

Question 7

The Postal Service proposed amendments would change the rules for small market tests by deleting "market disruption" as a basis for the Commission halting of the test and by increasing the limit for market tests for competitive products from \$10 million to \$100 million. In its explanation, the Service argues that any new postal product will inevitably have an impact on market conditions and contends that the higher limit enables the Postal Service to give a reasonable trial to various new competitive offerings.

Concern has been raised by the Coalition Against Unfair USPS Competition (CAUUC) and others that even the \$10 million limit could cause severe harm to small competitors of the Postal Service if the market test were conducted in a local market. The PRC testified that "apparently the Service doesn't want to have to worry about how its market tests are likely to affect conditions in pre-existing competitive markets, or to have Congress authorize the PRC to do its worrying for it."

What safeguards would the Postal Service suggest that would prevent unfair disruption in local test markets?

Given that H. R. 22 already permits market tests between \$10 million and \$100 million, what does the Postal Service amendment accomplish? Why isn't this redundant?

Response:

The Postal Service's revision to the market test rules eliminating the distinction between "ordinary" and "large" market tests is designed to recognize the inherent scale of Postal Service operations. The majority of market tests likely to be offered by the Postal Service are for products that are adjuncts to existing mail products and do not compete directly with the private sector. Limiting a "market test" to \$10 million, including the postage revenue from any existing mail class, unreasonably restricts the scope of most market tests. Even though H. R. 22 permits market tests between \$10 million and \$100 million, the additional burden imposed by the "large" market test rules limits the Postal Service's flexibility to respond rapidly to changing market conditions.

The Postal Regulatory Commission has the discretion to review any market test and this should provide sufficient safeguards to protect local markets from unfair disruption. However, we recognize that small businesses may be concerned if the Postal Service proposes large market tests focused on a very small geographic area. We are willing to work with the Subcommittee to establish conditions under which market tests expected to affect only a limited geographic area could be examined more carefully.

Question 8

The Postal Service proposed to limit its obligation to publish information about new competitive products to the basic rate (i.e., not discount rates).

Please explain what is meant by "basic rate" in the Postal Service's proposal?

Response:

The "basic rate" is the published tariff rate or publicly available rate for nonbulk mailings, and excludes any rates offered under negotiated service agreements. Rates under negotiated service agreements would also be provided to the Postal Regulatory Commission; however, to the extent these rates are considered to be commercially sensitive, information regarding negotiated service agreements for competitive products would be provided under seal. The prevailing practice in the parcel shipment industry is to hold these agreements secret. Not only are they not provided under seal to a regulatory body, but also typically, strong contractual prohibitions are placed against the firms divulging the content of their agreements. Conversely, the Postal Service's current process of public fee schedules with no conditions other than preparation requirements readily allows competitors to underbid the Postal Service.

For all noncompetitive products, the Postal Service would file a summary of the principal terms and conditions of the agreement and this filing would be open to inspection by the public. The terms and conditions of any noncompetitive, negotiated service agreement would be available to any similarly situated mailer.

Question 9

The Postal Service also proposes to reduce advance notice about new competitive products to 10 days (from 30 days). The Postal Service might view the shorter notice period advantageous from a competitive standpoint. But if the Commission finds that the action does not meet the requirements for new competitive products set forth in H. R. 22, the shortened notice period may prove a disadvantage by disruption of product rollout plans which could ultimately alienate committed customers.

What consideration has the Postal Service given to a possible downside to the considerably brief 10-day advance notice requirement it proposes?

Response:

By reducing the notice period for new competitive products to 10 days, the Postal Service is attempting to enhance its ability to compete effectively in a changing marketplace. Practically, the short public notice period will likely be used for rate and fee changes that have significant competitive impacts. Our competitors are not required to "telegraph" through a public notice period their decisions about changes in product and service offering, thus allowing any competitor to pre-empt their strategic decisions. The reduction of the notice period is likely to be less important for the introduction of new products requiring lengthy development efforts that significantly differ from existing competitive products.

Question 10

The PRC equates the term "product" in H. R. 22 as each rate cell. The PRC notes that this is important because H. R. 22 protects mailers of products from rate changes that exceed the price cap and implicitly imposes limits on increasing the overhead/institutional cost burden. The Postal Service proposed an amendment to equate products with current subclasses. The PRC notes that this amendment would allow the Postal Service additional flexibility to shift rate burdens among mailers by eliminating the protections of price caps and rate ceilings that H.R. 22 accords to all rate categories.

Was it the intention of the Postal Service to gain additional flexibility to shift rate burdens among mailers by eliminating the protection of price caps and rate ceilings by equating the term product to subclass?

If not, do you agree with the PRC's recommendation that H. R. 22 be clarified to preserve these protections at the rate cell level?

Response:

The Postal Service's intention was to preserve the current cost tests that underlie historical postal ratemaking. Under the Postal Service's rate cap and rate band proposal, significant protections are offered individual mailers (no rate can increase by more than 1.5 percent above the rate cap with additional protection for individual mailers in Basket 1 and nonprofit mailers in Basket 5) while ensuring that on average, no price increase for a basket exceeds the rate cap.

Many of the concerns underlying individual rate cell cost coverage appear to be based in the more global question of unfair "targeting" of competitors through manipulation of individual rates. These concerns can be addressed through the complaint procedure established at the Postal Rate Commission.

While cost tests are used today, the ratemaking criteria used as the basis for Postal Service rate proposals and PRC recommended rates are not solely cost based. For example, in setting rates, the Postal Reorganization Act requires that non-cost factors such as the value of the mail, the effect of rate increases on customers, and the educational, cultural and scientific value of the mail is considered. Fundamentally, there appears to be a misunderstanding of the ratemaking principles used under the current system. Currently, both the Postal Service and the Postal Rate Commission design rates using cost tests that require that all products cover their costs at the subclass level. However, at the individual rate cell level, there are and always have been individual rate cells where the rate does not cover its estimated costs. Some of these cells may result from the application of the ratemaking criteria to justify "smoothing" of rate changes between rate cells, or to recognize the unique characteristics of a particular rate element. For example, under the rates recommended by the Postal Rate Commission in its R97-1 Opinion and Recommended Decision, although rate subclasses as a whole covered their costs, many rate cells did not cover costs as allocated in the process as described in the response to Question 11.

Adding the requirement that every rate cell cover its costs would require the Postal Service to incur significant costs in revising data systems to collect data at an extraordinary level of detail. In addition, due to the relatively small samples that would underlie any rate cell data, rate decisions would be made based on data whose accuracy would be suspect.

Question 11

The Postal Service amendment defines minimum rates as covering attributable costs at the subclass level. Thus, rates within subclasses - even at the rate category level - could be priced below cost, in contrast to the current policy objectives pursued by the Postal Service and the Rate Commission today.

Why should certain noncompetitive rates be permitted to be priced below attributable costs since the attributable cost test applies only at the subclass level? Wouldn't this be a fundamental departure from standards of fairness for all mailers that has formed the basis of U.S. postal policy since the 1970 Postal Reorganization Act?

Response:

The cost test proposed by the Postal Service is the cost test that has been consistently used by both the Postal Service and the Postal Rate Commission. It is not a fundamental departure from the standards of fairness for all mailers that has formed the basis of U. S. postal policy since the 1970 Postal Reorganization Act.

There appears to be a misunderstanding of the ratemaking principles used under the current system. Currently, both the Postal Service and the Postal Rate Commission design rates using cost tests that require that all products cover their costs at the subclass level. However, at the individual rate cell level, there are and always have been individual rate cells where the rate does not cover its estimated costs. For example, under the rates recommended by the Postal Rate Commission in its R97-1 Opinion and Recommended Decision, although rate subclasses as a whole covered their costs, many rate cells did not cover costs ascribed to them. For example, the following rate cells do not cover costs as allocated in the process:

- Periodicals
 - ⇒ Editorial pound rate
- Post Office Boxes
 - ⇒ Group D post office boxes
- Parcel Post
 - ⇒ Machinable Inter-BMC Parcel Post
 - 156 of 483 rate cells do not cover costs
 - ⇒ Intra-BMC Parcel Post
 - 119 of 345 rate cells do not cover costs
 - ⇒ Destination BMC Parcel Post
 - 65 of 276 rate cells do not cover costs
- Standard (A) bulk parcel service
- Standard (B) Library Rate
 - ⇒ First pound rate

Question 12

In response to oversight questions last year, you stated that “smaller, more predictable rate adjustments are in the best interest of its customers and ultimately the Postal Service. These kinds of increases permit our customers to better plan their expenses and preclude the kind of ‘sticker shock’ that compel them to seek other alternatives.” Moreover, in your statement today, you observe that one of H. R. 22’s principle elements that can provide “positive, sensible reform” is the price cap feature, which has the potential for improving efficiency and providing customers “more predictability for their postage costs.”

The H.R. 22 price cap and banding mechanism requires that no individual rate will increase greater than the price cap. In contrast, the Postal Service proposed amendments would allow individual rates to exceed the price cap, as much as 1.5% or more depending on the use of banking and possible further modifications permitted to be sought by the Board. One of the major advantages to price cap regimes - and the current language of H. R. 22 - is that ratepayers can calculate their maximum possible increase - a “worst-case scenario” so to speak.

Why has the Postal Service made a proposal that seems to undermine the principle of predictability in order to achieve greater flexibility in changing noncompetitive rates?

What benefits do mailers obtain from granting the Postal Service added upward pricing flexibility above the price cap? In particular, please discuss how these benefits outweigh your stated goal of “smaller, more predictable rate adjustments which are in the best interest of Postal customers and ultimately the Postal Service;” what consideration has the Postal Service given to the impact of mailer uncertainty over possible maximum increases?

Response:

The Postal Service's proposal is designed to promote the principle of rate predictability while increasing the Postal Service's flexibility in changing noncompetitive rates. Under the current ratemaking regime, the Postal Service requests a rate change for all its products concurrently. For some classes of mail these changes can be quite large. However, in some instances, a particular class's costs may have "drifted," while the overall revenue requirement for the Postal Service has not changed significantly. The pricing flexibility under the Postal Service's proposed amendments to H. R. 22 will allow us to address this problem as it becomes apparent. This will reduce rate shock in those subclasses by associating rate changes with changes in the class's own costs rather than with the Postal Service's overall financial condition.

The Postal Service's proposals encourage predictability in that customers can evaluate whether a rate increase is possible from publicly available information. The potential for a rate change could be determined by weighing changes in the CPI (publicly available from the Bureau of Labor Statistics), any X-factor adjustments approved and published by the Postal Regulatory Commission, and subclass-specific cost data filed with the PRC through annual reporting requirements. Because noncompetitive rate changes can be made annually, these changes, if needed, are likely to be smaller than the less frequent rate changes under the current system. The additional flexibility proposed by the Postal Service through its rate cap and rate band mechanism will give the Postal Service the ability to respond to evolving market conditions in a business-like manner. Without this flexibility, the Postal Service runs a real risk of not being able to make gradual adjustments to market conditions, and being forced to file exigent rate cases to "catch up" or readjust its rate schedule to maintain its financial stability. For customers, this would be the worst of two worlds; they would incur "gradual, and predictable" rate changes under the H. R. 22 rate proposals, and because these proposals do not offer enough flexibility to the Postal Service, would also be subject to the "rate shocks" inherent in the current pricing system.

While no customer wants the price of products it purchases to increase in real terms, few customers expect that prices will not increase. Any postal reform legislation must recognize that either the cost characteristics of or the demand for some noncompetitive products may change in such a way that a price increase is warranted. Many of these changes are outside the control of the Postal Service (for example, a small increase in fuel prices), but do not rise to the level of cost changes envisioned as requiring an exigent case. The upward flexibility incorporated in the Postal Service's amendments gives the Postal Service a limited upward range to adjust its rates for this type of change. Without this added flexibility, significant time and resources will be spent litigating minimal price increases before the Postal Regulatory Commission through the exigent case procedures because that will be the ONLY mechanism available to the Postal Service.

As a final note, the question references the advantages of price cap regimes along with that proposed under HR 22. The system proposed by the Postal Service more closely resembles that of other price cap regimes than the pricing system proposed under H. R. 22. Perhaps the major difference between the price cap regime proposed by the Postal Service and those implemented in other industries is that the proposed pricing bands are relatively tight around the price cap.

Question 13

The Postal Service has proposed an amendment that would establish different, *cumulative* rate bands for baskets. In contrast, H. R. 22 limits the increase in one year to last year's price cap increase plus or minus 2 percent. Under its proposal the Postal Service could bank and then use allowable increases in a single year. From the Subcommittee's reading of the amendment, it appears that any increase would restart the accumulation of allowable cumulative rate increases.

Might this encourage the Postal Service to impose large infrequent increases that undermine the desire of some mailers for more frequent but smaller price increases in certain noncompetitive rates and result in "sticker shock"? What assurances can you give to mailers, such as the American Business Press who testified to their concern that with

the potential cumulative increase, they could be hit with the type of large increases the Service requested in previous rate and classification cases?

Response:

The Postal Service believes that H. R. 22 as proposed by Chairman McHugh includes a provision for cumulative banking of unused pricing discretion in §3732. This is explicitly recognized in the "Section by Section Analysis" which states

... any pricing discretion above the CPI-X percentage in a given year could only occur for a rate that had not been set at the maximum amount ... (thereby permitting use of banked pricing discretion).⁵

The Postal Service's amendments regarding banking conform to its proposed rate structure for the various Baskets. Although the banking mechanism is identical for each Basket, because the rate bands differ, the absolute amount of banking possible for each Basket also differs. Any rate increase that incorporates some "banked" pricing discretion will "use up" that portion of the discretion. In other words, if the Postal Service banks 0.5 percent of pricing discretion one year and in the next year uses that 0.5 percent of pricing discretion, that increment of pricing discretion cannot be used again. As proposed by the Postal Service, pricing discretion can be banked for no more than five years.

The Postal Service has no incentive to follow a pricing policy that results in rate shocks to its customers. Any company or organization that wishes to maintain and grow its business must consider the importance of price stability to its customers. Our customers have clearly indicated that they value price stability and, under H. R. 22, the Postal Service would aim to have a policy of stable, predictable price increases, yet balance that with a minimal amount of flexibility needed to fine-tune prices. Without banking, under a "use-it-or-lose-it" pricing regime, significant incentives exist for the Postal Service to use all its pricing discretion whenever possible. If there were any suspicion, no matter how small, that a price increase may be needed that exceeds the rate cap, without banking, the Postal Service would have to raise prices today to protect against the possibility that costs will increase tomorrow. In this scenario, the Postal Service is placed in a defensive posture and may be required to make pricing decisions now based on projections of what might happen rather than later when the facts are more apparent.

We understand the concerns expressed by the mailing community and are willing to work with the Subcommittee to reconcile the Postal Service's need for banking to ensure pricing flexibility with our customer's desire to avoid inappropriate banking followed by dramatic rate changes.

Question 14

The Postal Service has proposed an amendment to allow it to modify, by seeking a recommended decision, the rate bands on an individual product basis (i.e., to set product rates). The Postal Service's proposal cites the statutory standards for classification and not ratemaking for PRC review of such requests, and of course, as a recommended decision, the Postal Service Board can overturn it.

Why should the classification criteria - rather than the ratemaking criteria - be the basis for noncompetitive rate changes outside the price cap rules? By including a provision that allows price changes further outside the cap, doesn't this add to the upward uncertainty for the customers of noncompetitive products?

⁵ U. S. House of Representatives, Committee on Government Reform and Oversight, Subcommittee on the Postal Service, John M. McHugh, Chairman, "Section-By-Section Analysis H. R. 22: Amendment in the Nature of a Substitute," August 24, 1998, pg. 10.

Response:

The Postal Service does not intend to modify the rate bands on an individual product basis. The Postal Service's proposed amendment (Amendment 7: Concerning Price Bands for Various Baskets) would codify the rate bands for rate cells and we would expect to operate within these bands. The section of the amendment discussed in this question is designed to encompass the exigent circumstances that, due to conditions beyond the Postal Service's control, may require (very infrequent) price changes outside the proposed bands.

The Postal Service has no objection to this type of exigent rate band case being evaluated under the ratemaking criteria rather than the classification criteria. However, the Postal Service interprets Section 202 as amending section 3622(a) in the following way:

A request under this subsection [including section 3622(b), the ratemaking criteria] may not be submitted except in the circumstance described in paragraph (1) [establishment of baseline rates for new noncompetitive products].

This implies that the ratemaking criteria are not available for the type of case envisioned in the Postal Service's Amendment 7. The Postal Service would consider the 3622(b) ratemaking criteria acceptable for this purpose.

Question 15

With regard to the impact of the Postal Service's proposed amendments to H.R. 22 on the mailing community, please answer the following questions:

How would the Postal Service's proposed amendments to H.R. 22 benefit large business mailers?

How would the Postal Service's proposed amendments to H.R. 22 benefit the small business and home office mailers?

How would the Postal Service's proposed amendments to H.R. 22 benefit the single piece mailer or so-called "Aunt Minnies" of America?

Response:

The Postal Service's proposed amendments to H. R. 22 are designed to offer a reasonable pricing system that will benefit all mailers regardless of size. Our goal was to protect small mailers -- both Aunt Minnie and small businesses -- by ensuring that the noncompetitive pricing rules limited the potential rate increases for single-piece mail. While larger business customers may potentially benefit from negotiated service agreements which could allow innovative worksharing agreements, the conditions under which these agreements could be offered will also benefit the smaller mailer. Under our amendments, mail tendered under negotiated service agreements (including volume discounts) must provide an equivalent contribution to institutional costs as the most closely related standard rate schedule. In addition, our proposals allow negotiated service agreements offering premium services at a price above the standard rate (which will provide additional contribution to institutional costs), and seasonal discounts (which allow the Postal Service to more fully utilize its resources during traditionally slack periods). Any program that increases mail volume or reduces costs without cutting contribution can only serve to reduce the institutional cost burden on the smaller mailer.

The Postal Service's proposed amendments to H. R. 22's noncompetitive products pricing rules provide more stability and predictability for postal customers. Customers are protected from unexpected price changes, and special provisions protect customers purchasing single-piece, retail services (the mythical "Aunt Minnie") from rate increases above the inflation rate. In addition, the unique characteristics of nonprofit organizations are recognized, and, as compared to commercial rates, additional limits are placed on price increases. A limited degree of pricing flexibility has been reintroduced through rate banding which allows the postal prices to vary

around a rate cap tied to the inflation rate. The Postal Service is committed to providing reliable, affordable service to Aunt Minnie and all individual mailers. In fact, our rate cap and rate band proposals include specific provisions that place the most severe limits on the Postal Service's ability to increase single-piece rates.

Question 16

Concern has been raised that the pricing flexibility given the Postal Service under H. R. 22 will undermine cost-based worksharing discounts because there will be no requirement that worksharing discounts reflect cost savings.

What assurances can you give the mailing community that the Postal Service will continue to offer cost-based workshare discounts?

Does the Postal Service believe that cost-based workshare discounts send out the proper price signal and should be continued?

Does the Postal Service support a provision in H. R. 22 requiring that workshare discounts be based on measured cost savings or this information be at least reported to the Postal Regulatory Commission on a regular basis?

Response:

In conjunction with the Postal Rate Commission, the Postal Service has developed a program of worksharing discounts that is unique among the world's postal administrations. These discounts allow mailers to choose which mail processing and transportation they can perform at a lower cost than the Postal Service, and have resulted in growth in the mail service industry. In return, the mail processed by the Postal Service has become cleaner with a greater proportion barcoded and sorted to a greater depth. This all has reduced the mail processing costs of the Postal Service. In a general sense, the Postal Service's benchmark for performance under H. R. 22 is how mail is processed today. Therefore, we have no incentive to scale back any worksharing program that would reduce the quality of the mailpieces processed in Postal facilities, thereby increasing our costs. The H. R. 22 incentive regulation format would dramatically penalize any reduction in the Postal Service's worksharing program.

The Postal Service notes that at present it does not routinely report the measured cost savings associated with worksharing discounts to the Commission. These data are included as part of omnibus rate case filings in support of a specific pricing proposal. We understand one intent of H. R. 22 to be the replacement of the current cost-of-service regulation with an incentive pricing mechanism applicable to all noncompetitive rates. A large number of noncompetitive rates involve some degree of worksharing; imposing a requirement that all workshare discounts be strictly cost-based effectively excludes these rates from the pricing mechanisms proposed by H. R. 22.

Question 17

The Postal Service has proposed eliminating the required baseline rate case under H. R. 22. The baseline rate case was proposed for several reasons, but most important, it is to insure that the new incentive based price cap scheme starts out with "fresh" rates that are covering their costs, especially for international mail. Once rates are established, some rates fail to continue to recover their costs as time progresses until rates are changed again through a rate case.

How do you respond to the concern that without a baseline case, the cost coverages for the current rates will have drifted, in some cases considerably below cost?

Response:

The Postal Service proposed eliminating the baseline rate case on the presumption that its existing rates are fair and equitable. During the last omnibus rate case, the Postal Rate Commission heard and weighed the views of all interested parties including mailers, an officer of the Commission appointed to represent the interests of the general public, competitors, and the Postal Service, before recommending the existing rates. These rates are cost-based and provide a valid starting point for the new pricing structure. The baseline rate case merely repeats that process. Eliminating the baseline rate case will advance implementation of the pricing proposals embodied in H. R. 22. In addition, under the Postal Service's proposed amendments, a basic criterion for all products is that each subclass must cover its costs. If for any subclass, cost coverage has "drifted" below cost, the Postal Service would be required to increase the rates for that class. If the rate change were outside the range delineated by the rate cap and rate bands proposal, an exigent case would be required.

The regulatory structure proposed by H. R. 22 with the Postal Service's proposed amendments requires that all rates, both domestic and international, cover their costs. This is not a new requirement for international rates. The international rates scheduled for implementation in the spring of 1999 are designed to cover costs. In addition, a recent report by the Postal Service's Office of the Inspector General found that no cross subsidy existed at current rates between domestic and international mail. Over time, if rates remain constant, cost coverages can change. However, the cost coverage safeguards built into H. R. 22 will ensure that the Postal Service's current practice of designing international rates that cover costs will continue under the new pricing regime.

As a side note, in the telecommunications industry, a baseline rate case was not required. As John E. Kwoka, Jr. explained,

The rationale for initializing rates at existing levels is threefold: Such rates presumably represent the best current estimate of appropriate rates. In addition, since they represent the rates that would exist under continued cost-based regulation, any alternative that lowers prices relative to that benchmark constitutes an improvement. Initializing rates at existing level has the further practical advantage of avoiding taking on rate review simultaneously with price reform. A simultaneous rate review would give the company one additional opportunity to seek advantageous rates, and might even jeopardize reform itself.⁶

Question 18

The Postal Service has proposed elimination of the baseline rate case in favor of using the rates in effect eight months from the date of enactment effectively accelerating the introduction of all reforms. Concern was raised by the Postal Rate Commission that 1996 base year costs supporting the case did not reflect the attributable cost of the current classes and subclasses, since the current classes and subclasses developed in Docket No. MC95-1 (the Reclassification Case) were in place for only part of that period.

Does the Postal Service believe that the current rates are based on attributable cost estimates of sufficient quality for the current rates to serve as an accurate baseline?

Response:

The Postal Service believes that the cost estimates it provided in the course of Docket No. R97-1 before the Postal Rate Commission are the best available estimates of the costs of providing the current classes and subclasses of mail. While we understand the Commission's concern, we note that changes in the product mix occur frequently. For instance, FY 1998 data will not reflect the changes brought about by the most recent rate implementation. Continuous

⁶ Statement of John E. Kwoka, Jr., Professor of Economics, George Washington University Before the Subcommittee on the Postal Service, Committee on Government Reform and Oversight, U. S. House of Representatives, April 16, 1997, pp. 4-5.

delay to incorporate more recent information would be another instance when the "desire for the perfect becomes the enemy of the good".

Question 19

The Postal Service revenue requirement estimate in Docket No. R97-1 was controversial. Some have argued and results confirmed that the Postal Service over-estimated its revenue requirement. Current rates reflect this suspect revenue requirement.

How would you respond to those who argue that using current rates as a baseline would unjustifiably embed those costs in future rates?

Has the delay in rate implementation corrected for these overestimates by paying a "dividend" to ratepayers?

Response:

The Postal Service's revenue requirement was not over-estimated with respect to the time when current rates actually went into effect. Although the revenue requirement was estimated with respect to a Fiscal Year 1998 test period, and assumed that rates went into effect on October 1, 1998, current rates were not actually implemented until January 10, 1999, almost fifteen months after the beginning of the test year. By the time current rates were implemented, postal costs had experienced an additional fifteen months of inflation beyond that assumed in the rate case. Also, in Fiscal Year 1999, new labor contracts have gone into effect, increasing salary and benefit expenses.

Furthermore, the test year costs estimated in the Docket No. R97-1 rate case included major expenditures for new programs designed to improve the quality of service, maintain the Postal Service's infrastructure and improve future efficiency. Delays in the implementation of these programs deferred expenditures beyond the test year and into Fiscal Year 1999. By the time current rates were actually implemented, implementation of programs was on track and expenses were being incurred. These delays had a positive impact on the Postal Service's net income in FY 1998. However, this impact did not carry over into Fiscal Year 1999 when current rates were actually implemented.

Delaying rate implementation not only matched rates with the Fiscal Year 1999 cost levels that are higher than the Fiscal Year 1998 cost levels assumed in the rate case, it also gave ratepayers a direct \$800 million "dividend." This dividend is the payoff from delaying rate implementation six months past the time originally assumed in the Postal Service's financial plan.

Question 20

If there is no baseline case, these concerns might be addressed by having the Commission review all aspects of the Postal Service's revenue requirement in the first adjustment factor case to make what it deems to be appropriate adjustments.

What is the Postal Service's position in regard to this alternative?

What concerns, if any, would you have regarding the resultant changes in markups resulting from any adjustment, particularly with respect to possible rate complaints?

Response:

PRC intervention in defining rate levels in an adjustment case is antithetical to the use of a price cap ratemaking system. It would, in effect, overlay the current form of regulation over the new form of regulation and undercut the performance incentive mechanism embedded in price cap regulation. The Postal Service is staunchly opposed to this alternative.

The Postal Service feels that having the Commission review all aspects of the Postal Service's revenue requirement in the first adjustment factor case merely results in the adjustment factor case becoming a de facto baseline rate case. For the reasons stated in our response to Question 18, we do not feel a baseline rate case is necessary or appropriate if postal reform is undertaken. And for the reasons stated in the response to Question 19, the revenue requirement embedded in the rates is quite reasonable.

If a baseline rate case were undertaken, even in the guise of the first adjustment factor case, the resulting markups would be determined by the PRC presumably in accordance with the equal markup provisions of H. R. 22. Setting aside the Postal Service's objections to the proposed equal markup provisions, if such an adjustment factor/baseline rate case were to occur, the resulting rates would be presumptively fair and reasonable and could not be subject to rate complaints before the PRC.

The revenue requirement in the R97-1 omnibus rate case resulted in a historically low increase. By using the lowest contingency factor ever and the earliest test year, the Postal Service presented a revenue requirement that was significantly lower than precedent could have supported. Increasing the contingency or advancing the test year in more traditional manners would have resulted in significantly larger rate increases. Any review of the revenue requirement would have to incorporate these factors as well.

Question 21

Commissioner Goldway has stated that she is inclined to support that section of the Postal Service's price cap proposal which broadens the definition of products to current subclasses – as long as H. R. 22 also includes an amendment requiring the Commission to review and adjust the baseline rates every five years.

What is the Postal Service's position with regard to the suggestion that the Commission review and adjust the baseline rates every five years?

Response:

For the reasons discussed elsewhere, the Postal Service does not support an initial baseline rate case because we believe the current rates are presumptively fair and equitable. Moreover, a five year baseline adjustment case would appear to undermine the goal of predictability as baseline rates could change dramatically every five years.

Question 22

The PRC notes that over the twenty-nine year history of operations under the Postal Reorganization Act postal rates have generally tracked CPI. The PRC claims that unadjusted CPI as a price cap would make employees eligible for extraordinary bonuses simply for meeting a standard that has already been beaten. The PRC notes that this "lowers the bar for earning bonuses to the ground."

What is the Postal Service's understanding regarding the role of incentive-based price cap regulation as to encourage the regulated firm to control cost?

How does the Postal Service respond to the PRC view that CPI is a standard that the Postal Service has and can continue to meet under "business as usual" management?

What is the Postal Service's position with regard to the PRC's recommendation that H. R. 22 be amended to require it to set annual adjustment factors to reflect the evidence before it?

Response:

Incentive based price caps change the structure under which a regulated company or organization operates. Instead of pricing under a cost-of-service or "cost-plus" mechanism requiring regulatory review of any pricing decisions, incentive regulation increases the regulated organization's pricing flexibility while establishing a "risk-reward" mechanism. Under this system, flexible pricing rules are established that incorporate productivity benchmarks that the company must meet. If the benchmarks are met, the company benefits through greater profits, higher shareholder return or in the case of the proposed H. R. 22 postal reform legislation, managerial incentives. However, these benefits are not guaranteed in the same sense as they would be under a cost-plus system. If the benchmark is not met, the organization will not have the same level of returns. If the incentives are correctly designed, customers will benefit because the organization will have an incentive to use innovative methods (take more risk) to reduce cost growth (and consequently price increases) below the level that would have existed under cost-of-service regulation. However, legislation enacting incentive regulation must be carefully balanced to avoid setting an insurmountable hurdle (through a lack of pricing flexibility or an inordinate cost savings requirement) that the regulated company cannot hope to surpass. The Postal Service's proposed amendments are designed to increase the pricing flexibility within H. R. 22 and make the proposed legislation reflect a challenging but attainable goal.

The Postal Rate Commission is correct in its observation that postal rate increases have often tracked the level of increase in the CPI. While true for recent rate changes, that has not always been true. For instance, the increases in the early 1970's, and those resulting from R87-1 and R90-1 were above inflation. Nevertheless, the Postal Rate Commission's observation only addresses one side of the standard that H. R. 22 aims to impose. H. R. 22 is designed to moderate the growth in postal prices while ensuring that the Postal Service operates in an efficient manner and at least breaks even. While postal rate increases may have generally tracked CPI growth; over the same period, the Postal Service has incurred operating losses totaling \$4.4 billion since reorganization. This performance would not be rewarded under H. R. 22.

While recent performance has improved (benefiting customers through stable rates), the strong economic conditions cannot be characterized as "business as usual." When the economy begins to soften, and growth in postal volumes and revenue is not as easily achieved, H. R. 22 as modified by the Postal Service's amendments will create the incentive to continue to control costs and increase efficiency.

The Postal Service does not support the PRC's recommendation that H. R. 22 be amended to require it to set annual adjustment factors. This proposal acts counter to our customers' expressed desire for predictable price increases. If the adjustment factor is constantly changed, customers cannot reasonably project their postage costs and make appropriate decisions based on this information. In addition, litigating an annual adjustment factor case is likely to require the commitment of resources on a scale approaching that of an omnibus rate case. These are resources that could otherwise be directed by the litigants into their own business activities.

Question 23

The PRC has recommended the H. R. 22 include a requirement that the Commission present institutional cost burdens by subclass, the extent of any cost shift in burden since the baseline proceeding, and the extent to which rates for each of the various worksharing categories depart from cost based criteria and sound economic principle.

What is the Postal Service's position with regard to this recommendation?

Response:

The Postal Service believes that all data needed to perform calculations related to institutional cost burden by subclass will be provided under the cost reporting requirements of H. R. 22. Section 3772(a) requires the Postal Service to:

prepare and submit to the Postal Regulatory Commission a report . . . analyzing costs, revenues and rates in sufficient detail to demonstrate that the rates in effect during such year . . . complied with all applicable requirements of this title.

In addition, under section 3772(e) the PRC, not the Postal Service, has the power to determine what data is required:

The Postal Regulatory Commission shall, by regulation, prescribe the content and form of the public reports . . . to be provided by the Postal Service under this section.

The Postal Service notes that at present it does not routinely report the measured cost savings associated with worksharing discounts to the Commission. These data are included as part of omnibus rate case filings in support of a specific pricing proposal. We understand one intent of H. R. 22 to be the replacement of the current cost-of-service regulation with an incentive pricing mechanism applicable to all noncompetitive rates. A large number of noncompetitive rates involve some degree of worksharing and imposing a requirement that all workshare discounts be strictly cost based effectively excludes these rates from the pricing mechanisms proposed by H. R. 22.

Question 24

The PRC has recommended that in the interest of all parties that H. R. 22 specifically authorize the Postal Service to file a "realignment" case. The PRC contends that allowing the Postal Service to determine when such a case was needed adds to its flexibility which is one of the objectives of H. R. 22.

What is the Postal Service's position with regard to this recommendation?

Response:

It is unclear what a "realignment case" is in the context of this question. The Postal Service interprets H. R. 22 as allowing it to file a rate case with the Postal Regulatory Commission at any time under the exigent case provisions of H. R. 22 and therefore does not believe it needs additional "flexibility" as proposed by the PRC. The incentive regulation of H. R. 22 is designed to provide a mechanism for gradual price changes while encouraging the Postal Service to reduce costs and improve productivity. If H. R. 22 is enacted with the amendments proposed by the Postal Service, we would make every effort to avoid filing exigent cases absent a change in costs caused by factors beyond our control.

Question 25

The Postmaster General has described the equal markup rule as "artificial." However, to many it seems clearly reasonable and fair to competitors and captive ratepayers. The European Commission, as a way to protect monopoly ratepayers, has also adopted this same rule. The PRC finds the rule "eminently reasonable."

Please explain the Postal Service's justification for eliminating the equal cost coverage requirement as it relates to cross-subsidization between categories.

Response:

The equal markup rule is artificial in that it is a legislative contrivance designed to address a specific public policy concern. While all businesses must cover their overhead costs (institutional costs in postal terminology), the requirements of the equal markup rule have no equivalent in the marketplace and could be viewed as ignoring the realities of the business requirements of the marketplace. Moreover, as explained in the attached paper prepared by Christensen and Associates, its use can cause marketplace distortions that will work against the objectives of H. R. 22.

Nevertheless, we recognize the concern that "firewalls" may be needed to insure that the Postal Service does not compete unfairly. Therefore, we have proposed amendments that seek to further study the cost of providing competitive products, and then insuring that they are appropriately covered in the rates designed under the H. R. 22 pricing provisions.

Question 26

The Postal Service proposes to sunset this rule after five years. The Service contends that there are sufficient safeguards elsewhere in H. R. 22 to prevent cross-subsidies, and because the nature of the market for noncompetitive postal products cannot be predicted, the future cost coverages of those products are "problematic."

Please explain the "sufficient safe guards elsewhere" in H. R. 22 to prevent cross-subsidy between categories. How do you justify phase-out of the equivalent contribution requirement?

Under the Postal Service proposal, in year six (the first year without cost coverage rule), what protects captive customers and competitors from the Postal Service simply pricing all competitive products at cost and loading all overhead costs on noncompetitive customers?

What other entity in the competitive marketplace does not have to recoup overhead costs, let alone make a profit; what other competitor has a customer base resulting from statutory monopoly protections upon which it can move its overhead costs?

Response:

The basic pricing requirement underlying the Postal Service's proposed amendments to H. R. 22 is that all products (subclasses) whether noncompetitive or competitive cover their costs. By definition, this requirement eliminates the potential for cross subsidies between individual products or categories of products. The equal markup requirement as amended by the Postal Service can be used as an interim pricing restriction while the Postal Service restructures its competitive products in response to the increased flexibility given by H. R. 22. However, over time the discipline imposed by the competitive marketplace rather than the pricing relationships imposed by pre-H. R. 22 regulation should be the primary influence on competitive products.

Customers purchasing noncompetitive products are protected from drastic price changes in the first year without cost coverage rules by the price cap and band provisions of our proposals. In addition, the Postal Service faces competition -- even from "nonpostal sources" -- for many of the products defined as "noncompetitive." For example, First-Class Mail faces competition from electronic messaging as well as electronic bill presentment and payment alternative. It would not be in the business interests of the Postal Service, particularly under the regulatory incentives included in H. R. 22, to unfairly burden noncompetitive products with institutional costs.

While all businesses must recover their overhead costs, no business faces a regulatory mandate to impose a rigid relationship on costs across product lines. This is further discussed in the Christensen and Associates paper attached to the response to Question 25.

Question 27

At the February 11, 1999 hearing Ms. Elcano said, "... from our vantage point, putting all those factors together, we thought a five year sunset lets the bill take its new shape, lets the Postal Service adapt, addresses the cross subsidy through anti-trust". (emphasis added)

For the record, please clarify the Postal Service's understanding of whether "a cross-subsidy between categories" would be a violation of antitrust laws.

Response:

The important point to remember is that H.R. 22 is already designed to bring the Postal Service under the coverage of the antitrust laws. The "equal markup" rule, added to antitrust coverage, would expose the Postal Service to far more restrictive pricing rules than the antitrust laws impose on any private firm. This would confer a competitive advantage on the Postal Service's competitors by insulating them from price competition, to the ultimate detriment of consumers.

The antitrust laws forbid predatory (below cost) pricing only if there is a reasonable prospect that the firm engaging in such pricing can gain sufficient market power to recoup its present losses through higher than competitive prices in the future. If the structure of the market makes it unlikely or impossible for a firm to gain market power through predatory pricing, the fact that it prices below cost will simply benefit consumers without injuring its competitors.

In the current (and any foreseeable) business environment, it is not plausible to believe that the Postal Service has any reasonable expectation of gaining market power through predatory pricing. Our competitors, which are large and well-financed firms, dwarf our share of competitive markets. It would be folly for the Postal Service to attack these firms through predatory pricing, and then attempt to recover its losses by raising prices.

Even if it were reasonable to suppose that the Postal Service could gain market power through predatory pricing, the "equal markup" rule would still be inconsistent with antitrust principles and with consumer welfare. Under antitrust law, predatory prices must be below some appropriate measure of the predatory firm's costs. The usual standard for such improperly low prices is a firm's marginal or average variable cost. The "equal markup" rule would require the Postal Service to set its prices at considerably higher levels than this standard. (Indeed, the underlying requirement of H.R. 22 that the price of each competitive product cover its "attributable" cost is already more restrictive than the antitrust standard, because attributable cost includes not only variable costs, but also certain fixed costs that can be allocated to a particular product. The "equal markup" rule would pile another layer of pricing restriction on top of the attributable cost standard, which itself is more restrictive than the antitrust standard. While this would provide a luxurious degree of price insulation to the Postal Service's competitors, it would do nothing to benefit consumers.

Question 28

In your amendments, you have suggested the cost coverage rule should be put in place immediately and terminated after five years when a competitive products fund - as developed by the Postal Service and Postal Regulatory Commission - is put into place. The equal cost coverage rule is vital to protect both competitors and users of noncompetitive services.

How can you ask them to accept a repeal of the cost coverage rule when the details of this "new" competitive products fund or separation are undecided?

Response:

As we have explained in our responses to previous questions, the "equal markup" rule would provide an unprecedented degree of price protection to the Postal Service's competitors, at the ultimate expense of consumers. We believe it would be unconscionable to prolong its life beyond the five-year sunset date.

Question 29

In his testimony at the February 11, hearing, Postal Rate Commission Chairman Gleiman discussed the Postal Service's proposal to sunset the equal cost coverage requirement. He noted that the Postal Service's proposal doesn't require any contribution from competitive products after five years. He said this indicates that we're not going to be able to solve the problem of declining first class volume. He noted that even assuming that the Postal Service could shed volume variable cost, it still had substantial fixed overhead costs that it would have to cover. He wondered where the Postal Service expected to get the money from, if it doesn't require that competitive products make some contribution in year six.

How does the Postal Service respond to the PRC'S concern?

The Postal Service proposes that all transportation costs as well as costs dedicated uniquely to one specific product be exempt from the calculation of cost coverage when testing for compliance with this rule. In H. R. 22, the Commission is called upon to determine exceptions to the rule.

Recognizing that the Postal Service would still leave the authorization for the PRC in place to pass through costs exempted from the cost coverage calculation, why should the statute pre-determine certain costs to be passed through? Shouldn't this complex costing matter result from a well-vetted decision by the independent PRC rather than a decision hardwired in the law?

For the record, please provide a detailed explanation (citing principles of regulatory law or economics for the record) as to why all transportation costs should be exempt from the calculation of the cost coverage rule. Similarly, please provide a detailed explanation, (citing principles of regulatory law or economics for the record) as to why costs dedicated uniquely to one specific product should be exempt.

Would the Postal Service consider the cost of the Emery contract for the Priority Mail Processing Centers a cost dedicated uniquely to one specific product that should be exempt from the calculation of cost coverage in testing for compliance with the equal markup rule?

Please provide for the record costs that, in the Postal Service's opinion, are dedicated uniquely to one specific product, which should be exempt from the calculation of cost coverage in testing for compliance with the equal markup rule.

Response:

The Postal Service's proposed amendments to H. R. 22 require that all products, whether noncompetitive or competitive, cover their costs. We do not believe and have not suggested that the competitive products should not provide a contribution to institutional costs. However, as discussed above (see responses to questions 26 and 28), the equal markup rule imposes artificial requirements on the Postal Service that do not exist for any other competitor in these markets.

H. R. 22 as modified by the Postal Service's amendments establishes a general category of costs that would be excluded from the equal markup requirement and does not specify which individual costs would be excluded. That decision would presumably be made by the Postal Regulatory Commission in a rulemaking proceeding following the enactment of H. R. 22. It is appropriate to exclude purchased transportation and other costs uniquely associated with a product to the extent that, and in recognition of the fact that these costs are provided by the private sector and that an appropriate "markup" is already paid by Postal Service customers through the profit margin built into the contract price.

The Postal Service has not prepared a comprehensive list of the costs it believes should be excluded under this provision but, in general, feels that purchased transportation costs (including

air, highway and rail transportation) as well as unique third-party contracts for mail processing services and transportation such as the Emery Priority Mail Processing Network costs would be included. As indicated earlier, a definitive list would be prepared as a result of a rulemaking following the implementation of H. R. 22.

Question 30

The Postal Service proposes that competitive products newly transferred to the competitive category be exempt from the cost coverage rule for up to 2 years after transfer. The Postal Service contends this would give it a limited amount of "breathing room" for products newly moved. If a noncompetitive product has been transferred to the competitive category, it obviously has met the test for competitiveness. Upon transfer to the competitive category, the Postal Service would immediately have all of the pricing tools available to maintain its competitiveness, including published/nonpublished rates, volume discounts, etc.

Other than a desire for newly transferred competitive products to increase market share during this two year "breathing room" period, please provide any other justification based on identifiable regulatory theory or practice that would justify such an exemption.

Response:

The two-year exemption from the equal markup rule is designed to facilitate an orderly transition from the noncompetitive pricing requirements and the greater flexibility offered for competitive products. While all the competitive pricing tools would be available immediately for the transferred product, the addition of this product to the competitive category could require price changes to meet the equal markup requirement. If it were appropriate to change only the price of the newly transferred product, it may not be a sound business decision for the Postal Service to "shock" this product's customers with rapid and unexpected price changes. If the equal markup rule required, for example, a significant price increase, strong adverse customer reaction might result. Alternatively, if the equal markup requirement could be met by changing the prices of other noncompetitive products. Once again, customers' typically would prefer gradual price changes and the two-year exemption would allow more gradual price changes. The two-year exemption will allow the Postal Service to move prices in the appropriate direction without resulting in a sudden shift in pricing strategy.

Question 31

The Postal Service's amendment removes the PRC's advance review of proposed NSAs in the noncompetitive category. (Authority to enter into such agreements with regard to competitive products is inherent in the pricing authority in H. R. 22). The Postal Service would maintain certain standards already in H. R. 22 that ensures the NSA benefits those obtaining the agreement as well as those who do not. Such provisions include having to ensure its availability to other mailers who qualify, or the assurance that the NSA rate must make a contribution to overhead at least equal on an average unit basis to the rate or rates from which it was formed.

As you will recall, the first revision of the bill removed such agreements altogether from the noncompetitive category, and the existing NSA provision represents a careful effort to allow for agreements with the noncompetitive mailers that benefit the Postal Service as a whole, including those customers who may not qualify.

Why should the bill remove the limited 90-day pre-review by the PRC of these agreements? If H. R. 22 removed such advance review, would you agree, however, that public notice of the NSAs is important, both for assurance that they meet the statutory standards, as well as so other similarly situated mailers could learn about it and obtain it, as one of the statutory standards in the Postal amendment requires?

Response:

The Postal Service believes that the public notice requirement it has proposed is appropriate and recognizes its dual nature as a government agency and a competitor within certain markets. The shortened public notice period allows the Postal Service to tailor NSAs to the requirements of specific mailers while recognizing that significant (nonpostal) competition can exist for products included in the noncompetitive category. A complaint procedure allowing competitors or customers to challenge the provisions of the NSA will provide an appropriate forum for full evaluation of any allegations of improper conduct. If the Postal Service is found to have entered into an improper NSA, the Commission will be able to adjust any rates to lawful levels and take other appropriate remedial action.

The Postal Service has never suggested that noncompetitive NSAs be "secret deals" exempt from public scrutiny. We are committed to providing public notice of the terms and conditions of all NSAs, offering these terms and conditions to similarly situated mailers, and doing so in the most expeditious manner possible.

Question 32

The Postal Service's amendment requires that the payment of rates and fees during the term of the NSA are (i) reasonably calculated to yield revenues that equal or exceed the direct and indirect postal costs attributable to services performed under the agreement and (ii) a portion of all other costs of the Postal Service that are equal, on an average unit basis, to the portion of such costs reasonably assignable to the classification or classifications of mail service most similar to the services performed under the agreement. In the Postal Service proposed amendment on NSAs, the Postal Service adds two requirements for the contracting mail user: Specifically, (6) (B) furnish mail to the Postal Service in such amounts or at such times as may be specified in the agreement and (6) (C) pay the Postal Service a rate for enhanced services that is higher than the standard rate charged for an unenhanced service.

Given that the USPS also adopts the H. R. 22 requirement that noncompetitive NSA rates be based on the workshare principle that the worksharing mailer make the same per piece contribution to institutional cost as nonworkshare mailers, what purpose does this language serve?

Response:

The Postal Service's proposed amendment increases the scope of NSAs beyond the traditional worksharing (barcoding and presorting) discounts that are offered today. In all cases, every NSA must provide a contribution to institutional costs at least equal to that of the most closely related mail subclass.

Section (6) (B) allows the Postal Service to offer an NSA based on either the volume of mail tendered, or the volume of mail tendered at a specific facility, or the time (of day or of the year) the mail is tendered. This will allow the Postal Service to enter into NSAs that will better utilize resources that may otherwise be under-utilized. For example, the Postal Service could enter into an NSA requiring a mailer to tender a certain volume of mail at an assigned facility at a given time of the day, thus using capacity that would otherwise be under-utilized.

Section (6) (C) allows the Postal Service to offer an NSA for an enhanced service at a price above the standard rate. This will permit the Postal Service to offer innovative services that individual mailers may find attractive. Even if the service would result in additional cost to the Postal Service, that NSA must be priced to ensure that the contribution to institutional costs is at least as great as the most closely related mail class.

Question 33

The PRC has urged the subcommittee to reject the Postal Service's proposed amendment on negotiated service agreements. The PRC implied that the Postal Service amendments would allow a program of secret, non-tariff rates for monopoly and noncompetitive services to be negotiated entirely outside public scrutiny, and that the potential for abuse would be unacceptably high. The PRC said that requiring that defective NSAs be rectified only through complaints after the fact is procedurally inferior to prior public review, and would improperly shift the onus from the Postal Service to potentially aggrieved mail users.

How do you respond to the PRC's concerns? Can the Postal Service provide any further business or public policy justification for eliminating the transparency and protections for mailers and competitors regarding NSAs as in H.R. 22?

Response:

As a government agency, the Postal Service believes it has an obligation to provide public notice of the terms and conditions of any noncompetitive NSA and to offer those terms and conditions to any similarly situated mailer. We believe that the public notice requirement combined with strengthened complaint procedures before the PRC will protect mailers.

Question 34

The PRC has recommended clarifying amendments to §3641 stating: (1) that the negotiation of individual service agreements is not intended to become a substitute for broad-based changes in mail classification; and (2) that NSAs are subject to a requirement of producing net financial, as well as operational, benefits to the Postal Service and mail users generally.

Does the Postal Service support this recommendation?

In your written statement you say that the Postal Service would develop a proposal for the Competitive Products Fund that would include a "process for separating the costs, revenues, and financing of competitive products from those of noncompetitive products." The Postal Rate Commission has already worked a process of separating cost and revenues of postal products since 1970.

Why reinvent the wheel? Why do we need anything more than to provide for a division of assets, which is what H.R. 22 already provides?

Please explain why the Postal Service believes a "process" for creating a separate tracking system for competitive products is preferable to establishing the objective of a Competitive Products Fund and leaving the ability for the Postal Service and the PRC to work out the specifics (i.e., the "process") by a date certain?

Response:

The Postal Service supports the PRC's clarifying amendment "that the negotiation of individual service agreements is not intended to become a substitute for broad-based changes in mail classification" and will work with the Subcommittee to incorporate this into H. R. 22.

However, while the Postal Service believes that all NSAs should offer a net financial benefit, it does not agree that all NSAs should offer a net operational benefit. A "net operational benefit" implies that some increased productivity or efficiency would be gained from every NSA; however, the Postal Service has proposed an amendment (discussed in Question 32) that would allow NSAs based on an enhanced service offering at a premium price. This type of NSA could provide a benefit to a mailer and a net financial benefit to the Postal Service while imposing an additional operational cost on the Postal Service. Any such additional cost would result in additional

financial compensation through the NSA postage rates and keep the contribution to institutional costs at least as great as the most closely related mail subclass.

The Postal Service has proposed an alternative to immediately setting up the Competitive Products Fund proposed in H. R. 22. First, as we understand them, "Funds" are effectively checking accounts that transfer cash in and out. H.R. 22, instead, raises situations where, for example, assets are related to the Competitive Products Fund in ways that more closely resemble traditional accounting procedures for balance sheets, income statements and cash flow statements. We see this situation creating a lack of clarity as to the functioning of the Competitive Products Fund. We believe that a process for establishing the tracking and accounting for revenues, expenses, assets and liabilities of the competitive products would ultimately create the best and clearest practices. Second, since the competitive products will depend on access to public markets for debt, the clearest disclosure possible will result in the best relative funding costs.

Question 35

The amendment proposes that during this transition period that is not to exceed five years, the Postal Service could continue to borrow from the Treasury to support competitive products.

How do you respond to those who suggest that it is an unfair competitive advantage to allow the Postal Service to borrow money from the Federal Financing Bank at low government guaranteed rates to compete against private companies?

Response:

We believe that it would be a competitive disadvantage for the Postal Service if it has to immediately borrow from the public markets upon separation of the competitive products. Public markets investors look to a borrower's track record, among other factors, when determining how much to lend and at what rate. The competitive products performing under the constraints of H.R. 22 will not have a full track record for several years. We believe that investors will require a premium for not having a full track record of performance, which will initially put the competitive products at a competitive disadvantage to other private companies. Consequently, a transition period would help create a level playing field.

Question 36

The Postal Service under H. R. 22 will be given considerable freedom in the area of competitive products. The Postal Service has had considerable freedom to develop new products and price international products using volume discounting and contract pricing. It appears that the International Business Unit is struggling to attain its stated goals. Since its creation over three years ago the International Business Unit has developed a few new products and re-designed and renamed a few existing products.

What best practices and lessons learned can the Postal Service draw from its experience with international products that can help the Postal Service in meeting the challenge of pricing freedom in domestic competitive products?

Will the Postal Service need to augment its management and staff to modernize its approach to pricing competitive products or will it attempt to re-train current staff?

Response:

The International Business Unit was formed to develop a more competitive posture in the international markets. We have begun to develop programs that address our customers' needs in a very competitive marketplace. Many of these programs are of limited scope and can be characterized as innovative and experimental; over time we believe that they will be profitable. We revise these programs as additional information becomes available to ensure that they meet our customers' needs and provide a contribution to the Postal Service. Recent changes in foreign

economic conditions have resulted in reductions in mail volume. However, we have modified our international mail programs to ensure future success.

The Postal Service employs a large number of economists that have a wealth of expertise in postal pricing and costing systems. In addition, most pricing experts have advanced training in business and economics and experience in the private sector. Former members of the pricing staff have demonstrated their value outside the Postal Service following moves to private industry and other governmental agencies. While our current organizational structure was developed to operate within the existing regulatory environment, the skills and experience of the pricing staff are easily transferable, and may be better suited to a more flexible pricing environment such as that proposed under H. R. 22.

Question 37

Many people, including some in Congress, have criticized the Postal Service's entry into new non-postal markets and joint ventures with private companies. Nonetheless, H.R. 22 takes the view that the Postal Service should be given a fighting chance to expand its business in this area, provided it operates through a private law Corporation that has no special rights or powers. Although the Corporation idea was added to H. R. 22 to help the Postal Service in the future, the Postal Service has not been very vocal in its defense of this idea. I see you use the word "accept" in your written statement ("We can accept the concept of a corporation to provide additional separation for nonpostal activities. This could be a test vehicle for future reforms, provided the corporation has reasonable access to sufficient funding.")

Is the Postal Service supportive of the idea of the USPS Corporation, or would you just as soon be limited to the traditional postal business as Congressman Duncan Hunter has urged? Where is this in your list of priorities?

Response:

The Postal Service believes that the USPS Corporation could be of value to the Postal Service, provided it is structured with appropriate access to capital, a useful governance structure, and other features that allow it to compete fully with private companies. We most emphatically disagree that the Postal Service should be limited to its current lines of business. Historically, the Nation's postal establishment has been free to pursue new and improved services for its customers. While some of these efforts have not lived up to original expectations, the overall effect of postal innovation has been beneficial to the public.

Question 38

The PRC has expressed concern the USPS Corporation acquisition of another company would exploit its special relationship with the Postal Service as a customer or as a supplier.

What is the Postal Service's position regarding the PRC's recommendation that the USPS Corporation Directors should not be selected by the Postal Service Board of Directors?

What is the Postal Service's position with regard to the PRC's recommendation that postal managers should be restricted from transferring to jobs in the USPS Corporation and vice versa?

What is the Postal Service's position with regard to the PRC's recommendation that the USPS Corporation be required to pay a significant portion of its earnings as dividends to the Postal Service?

Response:

We believe that since under H.R. 22, the Postal Service is the 100 percent owner and sole provider of capital to the Postal Service Corporation, that its board should select the Postal Service Corporation Directors. The Postal Service Board is effectively appointed by the President of the United States with the consent of the United States Senate. In our view, it should be their responsibility to determine whether and how capital is devoted to the Postal Service Corporation and they should be held accountable for the performance of that capital. Consequently, they should control representation on the Postal Service Corporation Board.

The Postal Service does not believe that restrictions on staffing such as suggested by the PRC are appropriate. Legally, the Postal Service Corporation will be subject to the same laws as any corporation in the private sector. This includes all restrictions on post-Postal Service employment imposed by Congress in the existing statutes. If a former Postal Service employee could be hired in a similar position by a private firm, this individual should have the opportunity to seek that position with the Postal Service Corporation. Similarly, former Postal Service Corporation employees should have the same right to seek employment with the Postal Service as any other individual as long as all hiring decisions were in compliance with applicable Postal Service human resource guidelines.

The Postal Service Corporation Board of Directors should determine its own dividend policy. Key questions, such as whether to use excess capital as dividends or as financing for growth, should be made on a periodic basis as market conditions evolve. If the Postal Service Corporation Board of Directors is appointed by the Postal Service Board, constituents will be assured that the Postal Service Corporation dividend and capital policy is set in the overall interests of the Postal Service.

Question 39

In H. R. 22, the idea of the USPS Corporation is closely linked to the Competitive Products Fund. The main purpose of the Competitive Products Fund is to setup an account that defines how much money and assets you can transfer to the USPS Corporation, in addition to any borrowing that the Corporation may do on its own.

If we accept the Postal Service's proposal to leave the setup of the Competitive Products Fund to future deliberations by the Postal Service and the Postal Regulatory Commission, don't we have to postpone the establishment of the Corporation as well?

Response:

We recognize that the ultimate form and scope of the Postal Service Corporation's business activities will be influenced by numerous factors, including the final outcome of deliberations on the financing of competitive products. In the meantime, however, we believe it would be appropriate to establish the Corporation as a functional entity, so that it will be capable of playing a greater role as circumstances require.

Question 40

Recently, our nation's private carriers proposed to the Secretary of State that the United States support three changes in the UPU system: separation of governmental and operational functions, elimination of some anti-competitive provisions, and equal treatment for all competitive products under the UPU customs provisions.

Leaving aside the details of these proposals, do you think the United States should support these basic reform principles at the next UPU Congress? Why or why not?

Response:

Representatives of some of the private carriers have proposed changes in the UPU system that fail to take into account two key features distinguishing postal administrations from private operators: their universal service obligations and their responsibility to actually provide the

services established in the UPU Acts. The Postal Service supports changes moving the UPU in the direction proposed by the private carriers. These differences, however, will influence the shape and pace of change.

For example, the UPU has already made changes based upon the separation of governmental and operational functions to reflect changes made primarily among its European members. As members in other regions, including the United States, make similar changes, and more of its members support separate activities for these functions at a global level, the UPU will adapt accordingly.

The UPU provisions that the private carriers want eliminated as "anti-competitive" are seen by the large majority of UPU members as critical to the fulfillment of universal service obligations. They do not prevent mailers from using the services of whatever operator, public or private, they choose to use. They do permit countries to take steps to protect themselves against the loss of revenue from services based upon cream skimming and that encourage the migration of domestic mail to other countries for posting and then for return and delivery at rates that do not cover delivery costs. Changes in the UPU terminal dues structure, at least among industrialized countries, will reduce the concerns of private carriers about these provisions. It will take longer, however, for changes to reach a majority of developing countries.

UPU provisions that deal with the customs treatment of mail are also based upon the universal service and postal treaty obligations of UPU members. Customs authorities have developed clearance procedures for mail that are based upon these obligations and related differences in the traffic handled by postal administrations and private carriers. The Postal Service does support postal and private carrier collaboration, within the UPU and the World Customs Organization (WCO), to improve customs clearance procedures for all traffic, postal and commercial. Primary responsibility for adopting these changes rests with national customs authorities and the WCO, however, and not with the UPU.

Question 41

You stated in your testimony the competitive threat posed by foreign Posts. In a January 19, 1999 press release by the British Post Office, its CEO John Roberts states, "Within a 20 mile radius of where I sit in my office in London, there are bases for eight foreign post offices all actively working to win business from us - the Netherlands, Germany, the U.S., France, Sweden, Denmark, Switzerland and Belgium."

Please provide specific details on U.S. Postal Service offices that are established abroad to recruit business. Please include the length of time that these offices existed; a list of countries where employees and contractors have been sent; the numbers of employees and contractors indicating whether they are U.S. citizens or other nationalities; the amount of money expended during the period of time showing travel expenses separately, and the aggregate amount of business directly attributable to these activities.

Who oversees and is accountable for this activity?

Response:

The U.S. Postal Service has not established any offices abroad to recruit business or for any other purpose. The reference to the United States in the January 19, 1999 press release by the British Post Office is incorrect.

Question 42

A recent AP poll stated that three-fourths of Americans believe the Postal Service is doing an excellent or good job. Will the general public, the "Aunt Minnies" of the country support H. R. 22? What's in it for them?

The AP poll went on to say that the cost of stamps is too much. Any idea how much Aunt Minnie will pay for postage under H.R. 22?

Response:

Aunt Minnie, like other postal customers, will benefit from the regular, economical universal service provided by a Postal Service that has the freedom and flexibility to respond to the public's needs. In addition, under the price cap regulation established by H. R. 22, Aunt Minnie's postage rates should increase over time no more than the changes in the Consumer Price Index.

The exact rates that Aunt Minnie would pay depend on the X-factor and other variables, which are deferred to the Postal Regulatory Commission. These open-ended issues make the impact of the legislation highly unpredictable. The Postal Service has provided the Subcommittee model runs that demonstrate a wide range of possible outcomes if H. R. 22, as proposed, is adopted.

The Postal Service has offered amendments which, if adopted, would clarify the actual impact of the legislation and better protect the Postal Service's ability to carry out its universal service obligations.

Question 43

If we were to enact H.R. 22 today, as currently written, how would postal jobs be impacted? How about postage rates?

Response

Because many of its provisions would take time to implement, the enactment of H. R. 22 in its present form would not have an immediate impact on postal jobs or postal rates. Over time, however, the enactment of legislation that placed overly tight constraints on the pricing and marketing flexibility of the Postal Service would have an unfortunate impact on both postal employment and the level of postage rates.

The Postal Service has provided the Subcommittee model runs that demonstrate a wide range of possible outcomes if H. R. 22, as proposed, is adopted.

Question 44

How will the Postal Service address collective bargaining and wage issues under H. R. 22? How would you address collective bargaining under the Private Law Corporation?

Response:

The enactment of H. R. 22 would have no immediate impact on collective bargaining and wage issues within the Postal Service. It is possible, however, that the study of employee-management relations required under section 601 of the bill would ultimately lead to changes in both these areas. With regard to the Private Law Corporation, labor relations would be governed by the National Labor Relations Act, and the Postal Service would expect persons selected to manage the Corporation to adhere to that statute in all matters concerning collective bargaining and labor relations.

Question 45

Last month the GAO issued a report describing the major performance and management challenges that need to be addressed if the Postal Service is to sustain performance and remain competitive the 21st Century.

In what ways can the Postal Service further reduce costs and what savings can be realized from the ways you have mentioned?

Response:

Since Reorganization, the Postal Service has responded to numerous operational and managerial challenges. However, we recognize that GAO as well as many in the mailing community have had constructive suggestions for further improvements. Even in the absence of any postal reform, we will continue to act to improve service and to provide the products our customers want.

Postal reform, however, changes the basic ground rules for the Postal Service. Through statutory incentives, it will encourage management to develop innovative cost reduction programs. In addition, increased flexibility will allow the Postal Service to react more quickly to changing market conditions, and thus avoid "lost opportunities" resulting from the time needed for many regulatory proceedings.

Question 46

Can we in the Congress provide the Postal Service greater flexibility to set rates and offer new products quickly, without the establishment of a new price cap rate setting mechanism and the creation of a Private Law Corporation? If not why not? If so, how?

Response

The Postal Service has been discussing postal reform in the context of H. R. 22, and believes that if all its proposed amendments are accepted, H. R. 22 will establish a solid framework for a viable Postal Service in the 21st century. At this point, we feel an overarching vision of the Postal Service of the future is needed and are reluctant to propose piecemeal revisions to current statutes until that vision has been articulated.

Question 47

The Postal Service is grappling with labor-management issues, the challenges on containing costs, the need to better protect revenues, the need to implement reliable indicators of postal performance and risks from Y2K computer problems. Can we expect the Postal Service to address all these very serious matters and be subject to the type of postal reform envisioned in H.R. 22?

Commissioner Goldway, in her testimony, makes a number of very laudable comments and suggestions relative to postal reform. I would like your reaction to each of her thoughts:

H. R. 22 should rely more on the advantages of competition than protecting the marketplace from possible Postal Service competition.

H. R. 22 should encourage the Postal Service to be more efficient and innovative.

I would propose loosening the definition of postal product in H.R. 22 ...to allow for product innovation where there is a nexus to postal operations, and where the Postal Service can show that the new product will benefit from Postal Service scale or scope economies.

We should not curtail the ability of the Postal Service to be innovative just because of its size. As the Supreme Court has said, "low prices benefit consumers regardless of how those prices are set, and so long as they are above predatory levels, they do not threaten competition." Further, it has said, "it is in the interest of competition to permit dominant firms to engage in vigorous competition, including price competition."

Response:

Among other issues, the Postal Service is currently addressing the labor-management, cost containment, revenue protection and Y2K computer issues. We will have to continue to do this regardless of the outcome of the debate over H. R. 22. H. R. 22 is aimed at giving the Postal Service additional pricing flexibility, not at changing the way we deal with any of these other issues. However, to the extent additional pricing flexibility results in increased mail volume and increased revenue, the Postal Service may have more resources to dedicate to these important issues.

Generally, the Postal Service agrees with thrust of Commissioner Goldway's comments quoted above. We are a large organization encompassing both governmental responsibility for universal mail service and providing competitive products. Any legislative reform proposal must recognize that we have a unique obligation to provide service six days a week to every address in the United States, and that that obligation imposes costs on the Postal Service that our competitors do not bear. In addition, size is not inherently bad and does not necessarily result in an inherent advantage for the Postal Service in the competitive markets. The Postal Service is committed to providing its products without cross subsidy and will continue to do so regardless of the outcome of the H. R. 22 debate.

Question 48

Commissioner Goldway also makes the point that H. R. 22 "does not subject the operations of the Postal Service to federal laws and regulations concerning deceptive advertising." She is referencing the recent LIFE TIME FITNESS complaint case where the PRC found that the Postal Service's use of language in marketing material for advertising mail was "defective and inappropriate." Should H.R. 22 be amended to correct this problem? If not, why not?

Response:

As currently written, section 307 of H.R. 22 would apply the antitrust laws and portions of the Federal Trade Commission Act to the non-monopoly activities of the Postal Service. This section would also make the Trademark Act (otherwise known as the Lanham Act, 15 U.S.C. § 1051 et seq.) applicable to the Postal Service. Section 43 of the Lanham Act, 15 U.S.C. 1125, would provide a means for a business to seek damages based upon false advertising.

It should be noted that three federal circuit courts of appeal have held that the Lanham Act is currently applicable to the Postal Service. The Postal Service may be subject to suit for claims of false advertising, unfair competition, and trademark infringement within those circuits.

Section 603 of H.R. 22, moreover, would direct the Department of Justice to prepare a comprehensive report on the application of other statutes to the competitive activities of the Postal Service. We believe it would be wise to await the outcome of that report before taking further legislative action.

Question 50

PRC Chairman Ed Gleiman is very critical of a number of amendments submitted by the Postal Service. Those singled out specifically for rejection include changes to the rate setting process, which would impact bonuses and subject mailers from excessive rate increases. When can we expect further revisions of your amendments?

Response:

The Postal Service believes it has offered a comprehensive proposal for postal reform in the context of H. R. 22. We are willing to continue the dialogue with the Subcommittee, the PRC and mailers to develop postal reform legislation that will be acceptable to all members of the postal community.

The H.R. 22 Equal-Markup Requirement for Competitive Products

Christensen Associates

March 18, 1999

Section 3744 of H.R. 22 states that "[r]ates for competitive products shall be established in a manner such that the cost-contribution ratio for all competitive products (collectively) shall, for each year to which this subchapter applies ... be at least equal to the cost-contribution ratio for such year for all competitive and noncompetitive products (collectively)." Such an "equal-markup" provision is inconsistent with the economic principles of regulation and can have unintended and deleterious effects on the public.¹

The equal-markup requirement is not good public policy for the following reasons. First, the requirement is not needed to avoid cross-subsidization of competitive products. Second, it is harmful to consumers. Third, it will reduce the incentives for Postal innovation in noncompetitive markets. Fourth, the requirement is based on the erroneous notion that firms must apply an equal-markup to all their products in order to recover fixed costs.

The equal-markup requirement is not necessary to prevent cross-subsidization. Cross-subsidization occurs when the revenue generated from a product does not cover its incremental cost. Similarly, the courts have generally interpreted prices above unit incremental cost as not being predatory. Consequently, a price floor based on incremental cost, and not some arbitrary multiple of incremental cost, will provide the necessary protection against cross-subsidization and predatory pricing.

Even the protection of an incremental cost-based pricing floor may be of limited importance. Placing noncompetitive products under price caps will eliminate any financial incentive for the Postal Service to price competitive products below incremental cost. If the Postal Service decided to price competitive products below incremental cost, it would be unable to recover the

¹ The equal-markup requirement is defined in terms of revenue and attributable cost. While the term attributable cost is not a standard economic term, we interpret it to mean incremental cost.

resulting financial losses through a commensurate increase in noncompetitive product prices. In other words, pricing competitive products at less than incremental cost would leave the Postal Service less profitable than if it did not offer the competitive products. (Under cost of service regulation, a firm could, in theory, sell some products below incremental cost and offset those losses through price increases for other products.)

The equal-markup requirement is harmful to consumers because it sets an artificially high pricing floor for Postal Service competitive products. The Postal Service may be effectively excluded from competing in some markets, and competitors would be protected by a "pricing umbrella" created by the equal-markup requirement. The end result would be customers paying prices for Postal and competitor products above the prices dictated by market conditions.

Furthermore, to the degree that the Postal Service is excluded from competitive markets, it will be unable to obtain any contribution to fixed costs. If the lost contribution is large enough, the Postal Service may need to implement exigent price increases on noncompetitive products, once again making consumers worse off.

The equal-markup requirement will also have some unintended disincentives for innovation. Suppose that the Postal Service finds a way to reduce the incremental cost of some noncompetitive products. If it fully passes on the cost savings to consumers in the form of lower prices, the percentage markup on noncompetitive products will increase. Therefore it will be faced with two undesirable alternatives: reduce noncompetitive prices by more than the cost reduction, or raise prices on competitive products. Either alternative would seem to be a perverse "reward" for innovation. In the former case the Postal Service would have less contribution to overhead costs. In the latter case consumers would be hurt by higher prices for competitive products, and if the markets were highly competitive, the Postal Service would again have less contribution from the reduced volume.

The equal-markup requirement is based on the erroneous notion that

application of equal percentage markups on products is the only way to ensure that the Postal Service recovers its fixed costs. Many firms in the private sector also have fixed costs, and they must price their products to recover these costs. But these firms do not recover these costs by applying an equal percentage markup to the different products. Rather, markups for the different products are determined by market conditions. Markets in which competition is strong will not support large percentage markups, and the firm must set its prices close to incremental cost. This is to the customers' benefit, because they have more choices and lower prices. In fact, if a firm is required to impose an equal percentage markup on all its products, it may not remain competitive in some markets (since the prices would be too high). If this results in the elimination of competitive product lines, the firm would be forced to raise the prices on the remaining products, in order to continue recovering the fixed costs of its operation. All customers – those of competitive and noncompetitive products – would suffer.

One sees numerous examples of private firms using different markup rates for different customers. The airline industry has been particularly effective in segmenting their various markets and applying different percentage markups in those market segments. Long distance telephone carriers have also been effective in distinguishing their different market segments and deriving a variety of pricing plans for them.

To summarize, the equal-markup rule undercuts the two main goals of H.R. 22: the efficiency incentives of price cap regulation for noncompetitive products and the incentives to enter into and compete vigorously in competitive markets. In order to provide the full benefits of competition to the public, to provide incentives to the Postal Service for cost reduction, and to fairly protect competitors from unfair pricing practices, the appropriate price floor should be incremental cost, without any additional conditions. To accomplish these goals, we believe that the equal-markup requirement should be removed from H.R. 22.

Mr. MCHUGH. Our next panel, as I mentioned earlier, is comprised of the five commissioners of the Postal Rate Commission. Chairman Edward Gleiman; Vice Chairman Trey LeBlanc; Commissioner George Omas, a face not unfamiliar to us who have plied the House Chamber, a good friend and former staff member at the committee; also, Commissioner Ruth Goldway; and Commissioner Dana, also known as "Danny" Covington. So we welcome you all here today. Before you are seated, while you are up standing, let me rise and we can administer the oath.

[Witnesses sworn.]

Mr. MCHUGH. The record will show that all of the commissioners responded in the affirmative. So, again, welcome. We're glad you are here this morning. I will open with Chairman Gleiman, who is certainly no stranger to this committee room or certainly to this subcommittee. And I add, we welcome you back.

Having spent a good part of my last several days reading your extensive testimony, it was enthralling I assure you, page after page after page of it. I sound facetious and I should not. It was very thorough, very, very responsive and detailed. I do appreciate that because you gave us a great deal of not just food for thought but substance for thought, as well.

As I know you understand, time totally precludes us from your presenting that in its entirety. So we will, of course, submit that for the record in its entirety. We'd appreciate if you could point out those particular highlights that you think are most relevant here this morning. Although having read it, I can tell you that whatever you choose to focus upon will be relevant, because it was all very relevant and very helpful. So, welcome and thank you for being here.

STATEMENTS OF EDWARD J. GLEIMAN, POSTAL RATE CHAIRMAN, ACCOMPANIED BY W.H. "TREY" LeBLANC, VICE CHAIRMAN; GEORGE A. OMAS, COMMISSIONER; RUTH Y. GOLDWAY, COMMISSIONER; AND DANA B. "DANNY" COVINGTON, COMMISSIONER

Mr. GLEIMAN. I do feel at home with Jack Brooks staring down at me. I sat up there and had him do that occasionally during my 10 years as a staffer on the predecessor committee, the Government Operations Committee. I was somewhat relieved when I heard your opening, which indicated that this was not the impeachment hearing room. I was actually very relieved, because I know you read our testimony, and I was concerned that after reading it you might want to make it the impeachment hearing room.

Mr. MCHUGH. Not at all.

Mr. GLEIMAN. We do have a lengthy submission for the committee today. Before I start, let me introduce my colleagues, if I may? Vice Chairman LeBlanc is with us today, as well as Commissioners Omas, Goldway, and our newest commissioner, Commissioner Covington.

I have a summary that I've attempted of the testimony. I also have the short version, the shorter version and the shortest version. I think inasmuch as you've read the testimony, and I hope others will read the testimony, I'm going to go to the shortest version. If you want more, you'll tell me.

H.R. 22 with some fine tuning, save the private law corporation where we have some serious concerns, would appear to be workable. It would appear to provide an opportunity for the goals that were established at the outset, concerns over unfair competition, non-postal products, and losses of revenue due to decline in volume—not market share but volume—that the Postal Service is facing. These problems can be adequately addressed, with some tinkering, by H.R. 22.

Having said that, it is our considered opinion, by and large, that the Postal Service amendments are directly contrary to many of the bedrock principles of H.R. 22. The Postal Service amendments seem to erase many of the checks and decalibrate almost all of the balances that have been carefully and thoughtfully incorporated into the bill in response to the concerns of interested parties.

I could discuss at length the private law corporation at this time, if you would prefer, but, if not, we can go right to your questions. [The prepared statement of Mr. Gleiman follows:]



Testimony of
The Honorable Edward J. Gleiman, Chairman
on behalf of the
Postal Rate Commission
Before the
U.S. House of Representatives
Committee on Government Reform
Subcommittee on the Postal Service

February 11, 1999

Chairman McHugh, members of the Committee on Government Reform, Subcommittee on the Postal Service, thank you for the opportunity to provide testimony on H.R. 22, the Postal Modernization Act of 1999. With me today are my colleagues, Vice Chairman W.H. "Trey" LeBlanc, George A. Omas, Ruth Y. Goldway and Dana B. Covington, Sr.

I appeared before this subcommittee almost three years ago to testify on an earlier postal reform proposal introduced in the 105th Congress as H.R. 3717. The current proposal to modernize the Postal Service and alter the way it participates in the nation's economy is a substantially improved version of that earlier piece of legislation. That said, we intend to offer several suggestions that we think would improve it still more.

One reason that I preface my remarks here today with a reference to my earlier testimony is that a lot has happened since this subcommittee's response to the initial impetus for postal reform. In the early 1990s, mailers were reeling from the Postal Service practice of imposing large rate increases every three or four years, there were claims of unfair competition, and the Service was incurring year after year of multi-million dollar deficits. On top of that, there was the serious fear that technological advances in communication, in particular the widespread acceptance of facsimile and e-mail messages, might make the Postal Service obsolete.

This subcommittee responded to concerns that the Postal Service was in serious difficulty by initiating a dialogue on ways to solve its problems, and by developing draft legislation. Today's hearing represents a continuation of that dialogue. As the Chairman has frequently commented, he views postal reform as a work in progress. Since this effort began, low inflation, a strong national economy, the development of

new mail processing technology, and recently improved productivity have allowed the Postal Service to limit itself to moderate rate increases and still enjoy an unprecedented string of profitable years.

Despite the financial and operational accomplishments of the Postal Service over the past three years, the future still does not look particularly rosy. There is a consensus that it is just a matter of time before the large portion of the First-Class mainstream made up of bills and bill payments is susceptible to electronic diversion. This mail makes up nearly half of First-Class Mail. It tends to be "clean mail," that is, regular sized, letter envelopes that are accurately addressed, and it makes a disproportionate contribution to the \$20 billion institutional cost burden of the Postal Service. If a significant portion of this mail leaves, the Postal Service will be forced to impose steep rate increases unless it can sharply reduce its costs, find sources of substantial new profits, or both. The question all of us must face is whether H.R. 22 can help that process. We believe that with some adjustments, it may.

H.R. 22 has three major innovations. First, it would establish a new, "price cap" rate setting mechanism applicable to "noncompetitive" mail, that is, mail not currently subject to direct, effective competition. Second, it would allow the Postal Service freedom to set rates for its "competitive" products, while attempting to establish a level playing field. Third, it would authorize the Postal Service to establish a private corporation to operate subject to normal commercial laws.

I will discuss each of these three innovations in turn. In addition to commenting on the system that would result if H.R. 22 was enacted in its present form, I will discuss amendments to this legislation recently proposed by the Postal Service. Copies of the Postal Service amendments were provided to the Commission only recently, and we

understand that revisions may still be under consideration. Nonetheless, it appears to us that the Postal Service amendments are directly contrary to the bedrock principles of H.R. 22. These amendments would, by and large, erase many of the checks, and decalibrate many of the balances, that have been carefully and thoughtfully incorporated into the bill in response to the concerns of interested parties.

Before addressing the specifics of the three innovations in H.R. 22, let me briefly set out these bedrock principles. The first and foremost of these principles is that the Postal Service remains a basic and fundamental service provided to the people by the Government of the United States, and as such, it should be operated in a fair and nondiscriminatory manner. Mailers, suppliers, competitors, and other interested citizens should have assurances that the Service will perform its functions consistent with the policies set forth in Title 39.

The second principle contains two interrelated parts. If the Postal Service can be operated more efficiently, rates will not increase as fast as they would otherwise, and this will benefit both mailers and the nation as a whole; and, management and labor are most likely to operate more efficiently if they can receive personal, financial rewards, in the form of bonuses, for doing so.

A third principle is that competition between the Postal Service and private enterprises should be as fair as possible. In colloquial terms: competition should take place on a level playing field. H.R. 22 contains numerous provisions designed to level the competitive playing field.

H.R. 22 ties these three complementary principles together in a compact between mailers and the Postal Service. The consistent themes of H.R. 22 are to level

the playing field for competition between the Postal Service and private enterprise, and to provide mailers with lower rates by restraining price increases through the imposition of statutory price caps and rate ceilings that will hold price increases below the rate of inflation. It allows substantial bonuses to be paid if the Postal Service is operated profitably under these price caps. These themes explain H.R. 22, and the suggestions we offer here today are designed to foster those themes.

PRICE CAP RATEMAKING

The first innovation I will discuss is the substitution of price cap ratemaking for the current cost of service ratemaking system. Price cap ratemaking allows management the freedom to set rates, so long as rates remain below a fixed ceiling. H.R. 22 establishes a price cap that holds rate increases below inflation by allowing the Postal Service to change rates for noncompetitive postal products each year within a percentage range surrounding the previous year's change in the Consumer Price Index (CPI) less a factor to account for likely productivity improvements.

Private utilities operating under price cap regulation are motivated to operate efficiently because they are allowed to retain any profits they earn while providing service under capped rates. The Postal Service does not have residual claimants who demand a reasonable return for their equity investment. To motivate the Postal Service to operate efficiently, H.R. 22 establishes the opportunity for postal employees to earn substantial bonuses if profits are realized while providing promised services under capped rates.

H.R. 22 also includes a ceiling on rate increases so that, on a cumulative basis, they may never exceed the price cap. If, over time, the Postal Service holds increases

below the price cap, it may recoup the difference in subsequent years, so long as no increase is ever more than two percent above the applicable price cap for the current year. This assures that mailers will not be subject to large, difficult to absorb increases.

Price Cap Ratemaking Applied to Noncompetitive Products

H.R. 22 gives management authority to change rates for noncompetitive products without obtaining a recommended decision from the Postal Rate Commission. Its flexibility is not unlimited — there would be several important new statutory constraints, but within those constraints it can adjust rates more quickly to meet changing circumstances. Meanwhile the Commission's main role changes from recommending rates to exercising regulatory review and taking appropriate action in response to complaints from the public.

At the same time, the price cap regime proposed in the bill preserves many of the basic tenets of current law designed to prevent undue discrimination between groups of mailers, including the requirement that every postal product pay rates at least equal to the attributable costs of the service they receive. This is an essential protection that must be retained. We think that the balance of freedoms and restrictions on rate changes set out in the bill is fair, and that if agreement emerges from within the many segments of the postal community that price cap ratemaking will provide better and less expensive mail service than cost of service ratemaking, then H.R. 22 provides a sound basis for going forward.

However, the system described in H.R. 22 is not without potential problems. Current rates incorporate an extensive system of cost-based mailer worksharing rate incentives developed over time with the support of the Commission, mailers, and the

Postal Service. These worksharing discounts embody the economic principle of efficient component pricing, under which postal rates foster efficient use of society's resources. If future rates cease to reflect actual cost distinctions, mailers will receive inappropriate price signals.

If future rate discounts fall below actual savings to the Postal Service, mailers may stop performing worksharing that benefits the Postal Service and society as a whole. If future discounts exceed actual savings to the Postal Service, other mailers will have to generate revenues to offset these excessive discounts. This is a type of burden shifting. Currently, the Commission strives to fairly balance the amount of revenues over and above attributable costs that each type of mail must provide. When discounts exceed cost savings, what really occurs is that the mailers eligible for those discounts make smaller contributions to institutional costs.

Because the Service generally supports cost-based worksharing discounts, hopefully the fact that H.R. 22 does not require that discounts reflect cost differences, and continue to pass through identifiable cost savings, will not have any negative impact on rates. Nonetheless, the subcommittee may wish to consider adding language that requires worksharing discounts to reflect cost savings.

Although price cap ratemaking can be applied to postal rates, the system laid out in H.R. 22 is fairly complex. Let me say here that your staff has been exceptionally helpful in providing assistance to us as we have reviewed this legislation. Nevertheless I want to be certain that all of us — the Commission, the Postal Service, and affected private sector entities — understand how the bill intends this system to work.

Rate changes under new Chapter 37 would be applied to "products." Products is a new term, and we are not entirely certain of the extent that it is intended to incorporate the current divisions of a class, a subclass, a rate category, a rate cell, a rate element, or some combination of those terms as they are understood by mailers and the Commission in developing rates. The definition in § 3701 refers to the next level of subordinate unit below a subclass as a product. The levels of subordinate units below a subclass are rate categories in some instances and rate cells in other instances, yet in most discussions there has been an assumption that the same level (category, cell, or other) should be applicable to all items in a basket. It is our current understanding that each rate cell is a product.

This is important because H.R. 22 protects mailers of products from rate changes that exceed the price cap and implicitly imposes limits on shifting the overhead/institutional cost burden directly protected by these limitations.

The Postal Service also views the term product as difficult to interpret. It proposes to remedy the situation with an amendment that would equate products and current subclasses. This amendment would allow the Service additional flexibility to shift rate burdens among mailers by eliminating the protections of price caps and rate ceilings that H.R. 22 accords to subordinate units and further subordinate units of classes and subclasses.

In our opinion, a clarification that preserves the protections of H.R. 22 at the rate cell level is a more responsible way to proceed and eliminate potential confusion.

The Postal Service proposal to redefine products is part of a package of Postal Service amendments that would change the very essence of the system for setting

rates for noncompetitive products laid out by H.R. 22. As I mentioned earlier, the essential goal of the current Postal reform legislation is to cause rates for all mail to rise less quickly, as a result of improved productivity, and to provide a means to reward those who cause that improved productivity to occur.

The Service has presented a package of amendments to the ratesetting process that would: (1) eliminate those provisions that would provide an impetus for improved productivity and lower rates, (2) eliminate those provisions assuring that the benefits of improved productivity would be enjoyed by all mailers fairly, and (3) modify standards so that bonuses would almost certainly be available even if the Service became less productive.

Amendments of this nature subvert the purpose of postal modernization and reform legislation, and should be rejected.

Another amendment in this category is the Postal Service proposal that the "cap" on rate increases be changed. H.R. 22 limits rate increases to the change in the CPI less an adjustment factor to account for expected productivity gains. The Postal Service suggests statutory language that provides the adjustment factor would ordinarily be zero, and that would allow a negative adjustment only when "compelling" evidence indicates postal productivity will "consistently" exceed private non-farm sector productivity. Moreover, the Postal Service proposes adjustments that would allow rate increases to exceed growth in the CPI. Some circumstances would require that the adjustment factor be in excess of the change in CPI under its proposals. In sum, the Postal Service would eliminate those provisions that protect mailers from unjustified, excessive rate increases.

Additionally, the Postal Service's price cap regime appears to allow all cumulative banked increases to be applied to rates in any year. Thus, rate increases in any year could substantially exceed the CPI for that year. The Postal Service's amendments further exacerbate this problem by permitting, through the application of so-called banding, an additional amount of up to 1.5 percent over the cumulative increase, depending on the basket. This approach would undermine the inherent H.R. 22 philosophy of small predictable rate increases for the mailers.

One might ask why the Postal Service would want the price caps to be less restrictive. Recall that H.R. 22 provides substantial bonuses to postal employees if the Postal Service operates at a profit while adhering to the specified price caps. If price caps are set above the rate of inflation instead of below the rate of inflation, it will be far easier for the Postal Service to qualify for bonuses.

For example, assuming a change in CPI of 3%, the H.R. 22 approach with an adjustment factor of 1% would permit Standard A rate increases between 0 and 2%. The Postal Service scheme, with no adjustment and a banding range of minus 2% through plus 1.5% would permit rate increases of between 1 and 4.5%. It is much simpler to show profits when rates can be increased up to 4.5% than when increases are limited to 2%.

Over the twenty-nine year history of operations under the Postal Reorganization Act, postal rates have generally tracked the CPI. By making price caps less restrictive, rather than more restrictive as proposed in the bill, the Postal Service would eliminate assurances that rate increases would be restrained; by making its employees eligible for extraordinary bonuses simply for meeting a standard that it has already beaten, it lowers the bar for earning bonuses to the ground.

Before leaving the subject of price cap ratesetting for noncompetitive products, I do have a modest proposal that I believe would improve H.R. 22. The current legislation provides that every five years the Commission is to convene a proceeding to determine the appropriate adjustment factor to be subtracted from the change in CPI. It contemplates that this single adjustment factor would then be used in each of the next five years. I suggest that instead, the Commission be directed to set annual adjustment factors to reflect the evidence before it, so that if, for example, a new processing system is expected to result in large productivity gains during the last two years of a rate cycle, the Commission could set different adjustment factors for years 1 - 3 and years 4 and 5.

Negotiated Service Agreements

Section 202 of the bill would add a new provision allowing the Postal Service to enter into negotiated service agreements with users of monopoly and noncompetitive postal services. Allowing these bilateral agreements would mark a major departure from current ratemaking procedure, because the Postal Service would be authorized to offer customized reduced rates to individual mailers by contract, rather than by making discounts available to all potential users of a service under a uniform published schedule of rates.

In principle, negotiated service agreements could provide a new avenue of benefit sharing between the Postal Service and mailers who are willing to undertake additional cost-saving activities, as the Joint Postal Service/PRC Task Force on Postal Ratemaking found in its 1992 report. However, as that report also found, NSAs are desirable only when they depart from established rates and classification schedules "in

ways which add value both for the customer and for the postal system as a whole." (Joint Task Force Report at 54.) In practice, this means that NSAs make sense only if they are justified by demonstrable cost savings, operational benefits, and protection of the contribution to institutional costs made by the monopoly and noncompetitive mail categories to which they would apply. In short, the Postal Service has to be made better off.

As H.R. 22 recognizes, the availability of negotiated service agreements does not eliminate the need for classification cases. If the Postal Service believes that it may be appropriate to offer reduced rates for an activity that many mailers can perform, it should propose a classification case to establish a new discount category. Then the impact on revenues can be evaluated together with the other applicable statutory standards, and affected mailers will have the opportunity to express their views.

The new § 3641 contained in the current version of H.R. 22 addresses these concerns by imposing several protective criteria for negotiated service agreements. These conditions include requiring the performance of additional mailer functions, recovery of both attributable costs and an average unit amount of institutional cost contribution, liquidated damages to be paid by contracting mailers who breach minimum volume commitments or other material terms, a 3-year term limit, equal access to NSAs by similarly situated mailers, and the production of net benefits to the operation of a nationwide postal system. Most importantly, § 3641 requires the Postal Service to submit proposed NSAs to the PRC for advance consideration in a public, notice-and-comment proceeding. Implementing these requirements would be a challenging task for the PRC. In particular, it would be necessary to develop a cost base for each NSA that would fully quantify cost savings that would not impose new cost burdens on other

users of the same service. Nevertheless, NSAs could yield net benefits to all mail users and the postal system as a whole if the conditions set forth in H.R. 22 are retained.

The Postal Service proposes an amended version of § 3641 that would retain most of the substantive criteria applicable to NSAs, but would also subvert the new provision in a fundamental way. Under its proposed amendment, the Postal Service would be authorized to enter into NSAs without any prior review by the PRC, or even public notice. In place of a Commission notice-and-comment proceeding to consider proposed NSAs as contemplated by the bill's current provision, the Service's amendment would *only* allow an interested party an opportunity to file a complaint with the Commission after the fact, if the interested party somehow found out about the unpublished agreement. I emphasize the word "only," because another portion of the Service's proposed amendment would provide that, except for a complaint to the PRC and court litigation on the contract between the Service and its NSA partner, these agreements "shall not otherwise be subject to review by any court or administrative body."

There is nothing in current postal policy, the recommendations of the Joint Task Force on Postal Ratemaking, or what I understand to be the objectives of H.R. 22 that would justify a program of secret, non-tariff rates for monopoly and noncompetitive services to be negotiated entirely outside public scrutiny. The potential for abuse would be unacceptably high. Furthermore, requiring that defective NSAs be rectified only through complaints after the fact is procedurally inferior to prior public review, and would improperly shift the onus from the Postal Service to potentially aggrieved mail users. For these reasons, we urge the subcommittee to reject the Postal Service's proposed amendment on negotiated service agreements. We also would encourage the addition of clarifying amendments to § 3641 stating: (1) that the negotiation of

individual service agreements is not intended to become a substitute for broad-based changes in mail classification; and (2) that NSAs are subject to a requirement of producing net financial, as well as operational, benefits to the Postal Service and mail users generally.

One additional important point requires clarification. That is: are pieces subject to an NSA still considered part of their former "product" when applying price cap based rate increases and the "all products must recover attributable costs" standards to that product; or does each NSA constitute a separate product exempt from price caps?

Baseline Rate Case

An essential prerequisite to price cap rate setting is an initial schedule of rates that accurately reflects costs of service. H.R. 22 envisions a baseline rate proceeding within 18 months of enactment to establish a baseline rate schedule that fairly reflects current attributable costs and fairly allocates institutional cost burdens consistent with the criteria included in § 3622 of the existing law. There are no provisions for subsequent cases to realign rates in accordance with § 3622 criteria.

The Postal Service's proposed amendments to H.R. 22 do not contemplate any rate realignment proceedings at any time. Those amendments assume the rates in effect eight months after enactment of H.R. 22 are the rates to be modified by the first exercise under the price cap adjustment mechanism, and that any changes in CPI since the previous rate case (e.g. R97-1) would be banked and available as justification for rate adjustments. There would be no review of the Postal Service's revenue requirement and, thus, no opportunity to exclude amounts previously built in for contingencies.

Based on our experience with postal ratemaking, we have concerns about a process that jumps directly to the price cap mechanism without first realigning rates in a baseline proceeding. The Commission has found that cost and rate relationships of the various subclasses and rate categories are subject to rapid distortion, particularly in periods of technological change and modification of mail preparation requirements. Docket No. R94-1 provides helpful instruction on this point. The Postal Service proposed an across-the-board 10.3 percent increase for almost all rates which would have preserved rate relationships established in Docket No. R90-1. The Commission found that subclass costs and mail characteristics had altered rate relationships to the point that the proposed across-the-board rates failed to conform to the criteria of the Act. The Commission was required to recommend rates that adjusted subclass relationships significantly from those proposed by the Postal Service. More recently we have seen the introduction of advanced flat sorters that probably alter the costs that supported imposing certain surcharges in the R97-1 rate case. We have also seen reports of advanced OCR software that will read most handwritten addresses successfully, which may significantly lower the costs of processing some types of First-Class Mail.

Another factor suggesting the need for a baseline case is the influence of the three major classification reform cases, beginning with Docket No. MC95-1. Those cases resulted in a significant change in philosophy regarding mailer preparation of the mail prior to entry into the postal system. Mailers were required to do much more than formerly to ensure and improve the compatibility of their mail with Postal Service processing equipment and procedures. However, the recently enacted rates, the result of Docket No. R97-1, only partially reflect this new environment. R97-1 was filed using FY 1996 as the base year, the period for which actual operating data are projected to

the test year. The rates and classification changes resulting from MC95-1 were in effect for only one full quarter of FY 1996. Despite attempts by the Commission and the parties, efforts to update R97-1 data for the effects of the new operating environment were only moderately successfully. A baseline proceeding should occur before the price cap mechanism is implemented so that rate relationships reflect current mailer preparation requirements. Absent such a baseline case, any rate distortions caused by the changed environment will be enshrined in future rates.

It is inevitable that institutional cost burdens will shift over time among the various subclasses and services. All interested parties, and the rate adjustment process, could benefit from knowing how much change has occurred over time. H.R. 22 directs the Commission to issue, at least every six years, a report to the President and Congress covering postal operations and the regulatory system then in place. The legislation also requires annual Commission reporting on various aspects of postal operations. I suggest that this legislation include a requirement that in one of the above reports the Commission present institutional cost burdens by subclass, the extent of any shift in burden since the baseline proceeding, and the extent to which rates for each of the various worksharing categories depart from cost based criteria and sound economic principles. This would provide all interested parties the opportunity to assess the need for future realignment rate proceedings. In addition, it would be in the interest of all parties if the legislation specifically authorized the Postal Service to file a realignment case. If the timing of this realignment case is at the Postal Service's discretion, flexibility for the Service, an objective of H.R. 22, is ensured.

SEPARATE TREATMENT FOR COMPETITIVE PRODUCTS

The second innovation in H.R. 22 is the division of postal products into competitive and noncompetitive categories, and the development of separate rules for providing these distinct categories of products to the public. The legislation provides a specific list of existing products that are initially to be treated as competitive. A major feature of this division is that several existing subclasses are split, with portions in the competitive category and portions in the noncompetitive category.

Perhaps the most striking division affects First-Class Mail. H.R. 22 essentially limits the Postal Service monopoly to letters mailed for \$2.00 or less. This opens to competition items weighing more than 8 ounces, and Priority Mail is placed in the competitive category. Other significant divisions affect parcel post and international mail. Apparently on the assumption that the majority of single piece mailings in these classes are sent by individuals with little opportunity to utilize alternative carriers, in most instances single piece mail is considered noncompetitive while bulk mailings are classified as competitive.

Rate-making for Competitive Products

H.R. 22 gives the Postal Service broad latitude in setting rates and adjusting services for competitive products. Essentially, there are only two limitations: (1) that each competitive product cover its attributable costs; and (2) that competitive products in total have at least the same cost coverage as competitive and noncompetitive products collectively. These two standards are needed to assure that the playing field for competition is level.

The legislation also levels the playing field by clarifying that the panoply of fair trade laws and regulations are equally applicable to Postal Service competitive products and competing services offered by private enterprise. Within the ambit of those laws, the Postal Service is able to offer rate and service differentials between individual customers as private enterprises do. The legislation simultaneously adds provisions that enhance the Postal Service's ability to compete by allowing it additional flexibility to experiment with new products and develop special arrangements keyed to the particular circumstances of individual mailers. It is hoped that this additional flexibility will help the Service to explore new markets and respond creatively to changes in the hard copy delivery marketplace. The Postal Regulatory Commission is charged with evaluating complaints that the Postal Service is failing to adhere to restrictions described in Title 39, and with collecting sufficient information to support appropriate reviews of Postal Service competitive operations.

This balanced approach of granting the Service almost complete freedom to set rates and adjust services while subjecting it to most of the controls applicable to private industry should extend the benefits of competition to the users of competitive products. However, the Postal Service again proposes amendments which would seriously skew the competitive balance in its favor. These Postal Service proposals should be rejected.

The Postal Service does not specifically eliminate the requirement that each competitive product must cover its attributable costs, but its proposed amendments substantially weaken that standard. As I mentioned in the discussion of the application of price caps to noncompetitive products, the Postal Service proposes eliminating the concept of subordinate units in defining products. Thus, all competitive parcel post or international mail would be a single product. This would allow the Service to price any

of the various categories of parcel post below cost so long as revenue for the competitive portion of the subclass equals attributable costs. The Postal Service could then engage in protracted below cost pricing in attempts to capture competitive markets.

It is not in the public interest to allow the government to engage in destructive, below-cost pricing as a means of competing with private enterprises. The concept that subordinate units of subclasses should generate sufficient revenues to recover attributable costs is consistent with the basic cost of service rate standard that has been the pre-eminent means for assuring fair and nondiscriminatory postal prices since enactment of the Postal Reorganization Act.

The Commission also considers as eminently reasonable the proposition that competitive products should have at least the same cost coverage as all mail services combined. Private sector firms must cover overhead costs and generate profits. Competitive postal products should generate at least a proportionate contribution to the institutional costs of the Postal Service. If the average contribution is so high that it reduces the Service's ability to compete effectively, either the Postal Service has excessive overhead costs, or the rates for monopoly products are too high and should be reduced. There is no valid reason for captive customers to have to pay more toward overhead than users of competitive services.

The Service would completely eliminate (after 5 years) the obligation of competitive products to make any contribution to the overhead of the Postal Service. It is unclear how users of monopoly products, or the Postal Service as an organization, would be assured of any benefits from its competitive products. The only beneficiary possible would be the private law corporation, which under H.R. 22 is funded from

surplus competitive fund contributions. By eliminating the H.R. 22 equal contribution requirement, the Service would make any revenue above cost into excess profit available for transfer to the private law corporation.

Postal Service material suggests somehow separating the assets, liabilities, revenues, and costs between competitive and noncompetitive segments of the Postal Service, and implies that it would treat the provision of competitive products as an independent enterprise; but it does not actually propose that a separate, tax-paying private corporation be established to offer competitive postal products through arms-length purchases of acceptance, processing, transportation and delivery services. To the contrary, its proposed amendments would preserve and expand benefits such as exemptions from lawsuits for its competitive products. Its brief discussion does not mention an allocation of a fair portion of the overhead burden to competitive products. Furthermore, in deciding during the first five years whether competitive products as a whole make a sufficient contribution, the Postal Service would remove attributable "purchased transportation costs and operational costs (such as those for dedicated processing networks) which are uniquely associated with a specific product" from the equation.

In sum, the Service has attempted to fashion a best-of-both-worlds environment for competitive products in which it would retain the protections of a government service but provide no certain contribution to the financial health of the organization. By excluding purchased transportation and dedicated processing costs, it would be able to claim that almost any subclass covered its costs while engaging in what would otherwise be forbidden as predatory pricing.

The Service also proposes to alter the review and reporting obligations of the Commission so that it would not be authorized to evaluate and report to Congress on whether the rates and fees for competitive products (individually or collectively) were in compliance with applicable provisions of Title 39. These Postal Service amendments to H.R. 22 should be rejected. We are also firmly opposed to a number of the amendments suggested by the Postal Service which seem designed to prevent either the Commission or the courts from exercising effective review of potentially anti-competitive acts. There is no justification for exempting the Postal Service from the standards private companies must meet.

Finally, H.R. 22 provides the Commission with authority to require the Postal Service to cease offering a competitive service that consistently fails to recover attributable costs. The Postal Service proposal eviscerates this provision which protects both monopoly mailers and competitors. It would limit the Commission to responding to a complaint, if such complaint follows three successive years of failure to recover attributable costs by a competitive product. Furthermore, the Service seeks to limit the "remedies" following such a proceeding to a Commission public report and/or a recommendation that the Postal Service take some action. These remedies are obviously inadequate. Note too, that by adding a special provision titled "Complaints Regarding Loss-Making Products" the Service becomes able to argue its proposal pre-empts the right of a concerned competitor to file a complaint under § 3662 unless there are three successive years of below costs revenue, or to obtain any of the more useful forms of relief provided for in that section.

The Division Between Competitive and Noncompetitive Products

H.R. 22 includes provisions for moving products between the competitive and noncompetitive categories, and for placing new products within the appropriate category. The legislation appears to consider both monopoly products and products over which the Postal Service exercises market dominance as noncompetitive. The Commission would bear responsibility for applying these provisions.

The Postal Service proposes an amendment that would redefine the distinction between competitive and noncompetitive products so that mail not subject to the private express statutes could be reclassified as competitive, but only if the Postal Service initiates such a transfer. This proposal is troublesome on its own. However, as mentioned previously, the Service also seeks to eliminate the requirement that competitive products would be expected to contribute a fair share of postal overhead. These amendments, when taken together, would permit the Service to burden a shrinking pool of captive customers with recovering all of its institutional costs.

The mechanism in H.R. 22 for allowing products to move in to or out of a particular basket successfully balances the need for flexibility to foster Postal Service innovations with the need for private enterprises to have some protection from unfair Postal Service actions. The Postal Service would eliminate the opportunity for the Commission or members of the public to initiate the process for moving products between baskets and between competitive and noncompetitive. It explains that it wants to retain control over its product line. However, the movement of products between baskets is accomplished by classification cases, which are subject to final decision authority of the directors. The Postal Service could not be forced to accept a change.

We believe affected members of the public should retain the opportunity to obtain a meaningful public review of the Postal Service categorization of its products.

The question of whether a service is competitive or noncompetitive is also best left to independent outside review. Recall that the Postal Service proposes that the parts of a competitive subclass should be allowed to be priced below costs if the subclass as a whole covers its cost. If the Service has inherent advantages so that it has market dominance as to a portion of a subclass, it could use its position to compete unfairly. Affected mailers and competitors should have the right to seek reclassification.

A final disturbing aspect of the Postal Service comments and proposals is their complete focus on the competitive portion of its operation. The vast majority of the current mailstream is within the noncompetitive arena. Most of the individuals and businesses that rely on the Postal Service for essential services use noncompetitive products. The Postal Service states in comments explaining its legislative proposals that it expects all new products to be in the competitive arena. For the Postal Service to remain a valued and viable public service, it must focus its attention on providing service improvements the users of noncompetitive mail will need in the coming years. Mail users, and the nation, do not benefit if the entire intellect of postal management is focused on improving and supplementing its competitive product line and bolstering its private law corporation, leaving the majority of existing mail services to stagnate or even deteriorate.

PRIVATE LAW CORPORATION

I now will turn to the third major innovation of H.R. 22, the provision allowing for the establishment of a private law corporation by the Postal Service. This is a concept

that is new to postal reform. The former H.R. 3717 did not provide for a private law corporation, so no public record has been developed on its pros and cons.

The private law corporation in H.R. 22 can engage in both postal and nonpostal activities. It is intended to be separate from the Postal Service, and the Commission is charged with assuring that when the corporation purchases services from the Postal Service, the prices paid are fair to ratepayers and competitors. The directors of the Postal Service would select the directors of the corporation.

Our understanding is that in its original conception, the private law corporation was simply a means for the Postal Service to offer nonpostal products without having them underwritten by monopoly revenues and without having the government, as such, entering new areas of competition with the private sector. The development of nonpostal products by the Postal Service was considered desirable by some as a means of generating profits which could then be used to offset losses incurred from the widely anticipated diversion of lucrative First-Class volume to electronic media.

The concept of the private law corporation has evolved, however. Some observers believe it is a mechanism for the Postal Service to acquire other companies and to form partnerships and alliances with firms in the private sector. As written, H.R. 22 permits the private law corporation to offer to the public every kind of postal and nonpostal product. In fact, the private law corporation is so broadly defined that it even could serve as a contractor to the Postal Service to perform collection, processing, transportation and delivery of monopoly products, thus allowing the Postal Service to become a "virtual" entity, hollowed out so that it consisted of little more than a contract and ratesetting shop. In addition H.R. 22 seemingly allows the private law corporation to engage in activities which have absolutely no nexus to the Postal Service.

Just as the mission of the private law corporation has evolved so has its funding. Initially, the monies available to the private law corporation were thought to be limited to the so-called surplus in the competitive products fund. The surplus would consist of overhead contributions from competitive products above what is required by the equal markup provisions of H.R. 22. Recently we have heard it suggested that the private law corporation could be funded by asset sales from the competitive product fund balance sheet. These might be in the form of sales to the Postal Service with a lease back provision. The Postal Service even goes so far as to propose that all competitive product revenues (not simply profits) could be injected into the private law corporation. The Service also wants the bill amended to allow the private law corporation to sell stock to the public and to its own employees. As we understand it, the bill already allows the private law corporation to set up subsidiaries which could sell stock.

The desirability of the Postal Service engaging in nonpostal activities, the scope and effect of the private law corporation's activities, and the manner in which the private law corporation will be funded raise important issues of public policy which need to be examined.

Scope and Effect of Private Law Corporation Activities

Currently, the Postal Service offers a limited number of low-revenue, nonpostal products competing with the private sector under the mantle of the U.S. Government. We believe it is generally inappropriate for the government to enter into competition with the private sector. It is especially so when the government claims numerous special privileges such as exemption from taxes and fair trade laws. Nevertheless, if the Postal Service is going to engage in nonpostal activities, the private law corporation is an

improvement over current practice. H.R. 22 recognizes the need for a level playing field and this is highly desirable.

We recognize that nonpostal activities can be far more glamorous than collecting, processing and delivering mail. It is more exciting to contemplate being a player in electronic commerce, buying stakes in publicly traded corporations, and entering into partnerships with private companies. Because the Postal Service has a large amount of fixed costs, profits earned by the private law corporation would be welcomed to offset a portion of its overhead burden. They would be especially welcomed if substantial volumes of highly profitable First-Class Mail are lost to electronic media. Nonetheless, we must question whether the potential for gain exceeds the potential for loss to the Postal Service, and whether society and the general economy will be better or worse off if the Postal Service uses substantial postal revenues or assets to engage in nonpostal activities.

In our opinion it is dubious that a private law corporation spun out of the Postal Service would be able to make a sizable contribution to the \$20 billion institutional costs of the Postal Service. We say this because it is hard to make profits in our competitive economy. The Postal Service's recent experience with new products, as described by the GAO, supports our concerns. Virtually every nonpostal product would have very significant competition. More importantly, nonpostal products would not benefit from the scope and scale economies of the Postal Service as do letters and parcels. We see few comparative advantages for the private law corporation in offering nonpostal products beyond the ability to get capital without meeting the tests that ordinary startup corporations must meet.

We see no justification for the private law corporation using Postal Service assets to finance businesses or products totally unrelated to providing postal services. A somewhat better case may be made for the private law corporation exploring opportunities to sponsor vertical or horizontal integration in the postal sector. Remitco is an example of vertical integration already put in place by the Postal Service. Other possible examples include purchasing transportation companies or letter shops. Examples of possible targets for horizontal integration would be small parcel delivery companies, overnight delivery firms, money order firms and alternative delivery firms.

Title 39 describes the Postal Service as "... a basic fundamental service provided to the People by the Government of the United States ..." As such it must deal fairly with its customers and suppliers. Current law prevents the Postal Service from unduly discriminating among its customers. Current law also limits the Postal Service's flexibility in choosing its suppliers. In short there is now a level playing field among the Postal Service's customers and suppliers. We believe that vertical and horizontal integration in the postal sector would be very likely to slant those level playing fields.

The logic behind the private law corporation purchasing another corporation presumably would be that the acquired company would become more profitable as a result of its new corporate alignment. If the company does not become more profitable, the private law corporation would not gain much from its acquisition assuming it paid a fair market price. We must ask: how will an acquisition by the private law corporation lead to greater profitability? The obvious answer is that it could become more profitable by exploiting special relationships with the Postal Service as a customer or as a supplier. It does not seem possible to have a level playing field while honoring special relationships.

Finally, we believe it is essential that the management of any private law corporation should have an arms length relationship with the Postal Service. Consequently, the private law corporation Board of Directors should not be selected by the Postal Service Board of Directors. For the same reasons, there also should be restrictions on postal management transferring to jobs in the private law corporation and vice versa.

Important issues also arise from the concept of allowing the private law corporation to offer postal products to the public that are currently being offered by the Postal Service. If the private law corporation drains mail that is making an overhead contribution from the Postal Service, it hurts the Postal Service financially and leaves rate payers worse off. The only way rate payers could benefit would be if the private law corporation improved the profitability of postal products, and then returned these enhanced profits to the Postal Service in the form of dividends. Unless these dividends exceeded the contribution otherwise being made by the product, the Postal Service would be harmed.

Allowing the private law corporation to offer noncompetitive but nonmonopoly products not only has the potential to drain overhead contribution from the Postal Service, it also would eliminate the protection the bill provides to captive ratepayers. Furthermore, it would be in direct conflict with the market dominance test incorporated in H.R. 22. As we understand it, the private law corporation could offer nonmonopoly, noncompetitive products in spite of the fact that the Postal Service has market dominance in these areas. This would allow the private law corporation to serve profitable segments while leaving unprofitable segments to be served by the Postal Service. This could directly undermine the financial stability of the Postal Service.

Thus we believe that *de facto* monopoly products such as publications mail should not be offered by the private law corporation.

Financing of the Private Law Corporation

H.R. 22 recognizes that the current law which allows the Postal Service to enter into nonpostal activities with an unlimited draw on monopoly revenues is unwise. The bill specifies that surplus monies from the competitive products fund and borrowing without the full faith and credit of the government are the sources of capital for the private law corporation. This is a great improvement over current practice.

H.R. 22, however, is not completely successful in insulating rate payers from becoming the implicit underwriter of the private law corporation. Under current law, all the institutional contribution from competitive products is available to defray institutional costs. Under H.R. 22, surplus contributions from the competitive products fund could be directed to the private law corporation. Unless the stream of dividends returned to the Postal Service from the private law corporation exceeds the amount of funds the Postal Service invested in the private law corporation, the Postal Service and ratepayers are less well off.

Moreover, other options could be far more harmful. For example, assume the Postal Service were to purchase and lease back from the competitive products fund assets allocated to competitive products. The proceeds from these sales could provide a substantial source of funds for the private law corporation. Under any form of funding it is possible that the private law corporation might be able to manage to return only an anemic stream of dividends, or it might even go bankrupt. Under either circumstance, the Postal Service would fail to recover its investment.

The American economic landscape is littered with failed companies. There are no guarantees for new ventures. Thus, we are inevitably faced with an assessment of the risk to Postal Service rate payers. We must ask, does the private law corporation present a good risk-reward tradeoff for postal rate payers? At this point, we don't have an answer to this question. Until the concept of the private law corporation is further developed, no one can answer it. But surely we should answer this question before the private law corporation is enacted into law. The private law corporation will not be getting its capital in the normal manner; that is from investors willing to accept risks in order to reap rewards. The capital contribution to the corporation by postal rate payers will amount to an involuntary assessment.

We must also ask if it is in the public interest for a private corporation funded with involuntary contributions from postal rate payers to compete in the market place. With involuntary funding, the equity base of the private law corporation will be larger than if all funds came from voluntary investors. Such an enterprise would distort the competitive market.

If there is to be a private law corporation, we think H.R. 22 would be strengthened if it required the private law corporation to pay a significant portion of its earnings as dividends to the Postal Service. Paying dividends to the Postal Service is the only way the private law corporation can mitigate the impact on mailers of the expected decline in hard copy mail. Since postal rate payers will provide at least the initial capital of the private law corporation, it is appropriate that they be major beneficiaries of whatever financial success the private law corporation enjoys. Initial investors usually receive a disproportionately large ownership stake by virtue of being first and therefore taking the most risk.

While H.R. 22 would make surplus contribution from the competitive fund available to the private law corporation, a Postal Service proposed amendment would be much more liberal. It would allow all revenue from competitive products, not just surplus contribution, to be used to capitalize the private law corporation. We believe the Postal Service proposal violates important safeguards included in H.R. 22. Any financial firewall between the Postal Service and the private law corporation would be breached if the corporation is permitted to use competitive product revenues in this way.

Most importantly, the Postal Service's role changes from investor in the private law corporation, using surplus profits, to cash cow susceptible of being plundered by the private law corporation. In addition, the Service's proposal would further diminish the likelihood that the competitive products side of the Service would be of benefit to noncompetitive products customers. Of course, the Postal Service amendment which eliminates the equal markup provision of H.R. 22 also frustrates this objective. Finally, the potential impact on the private sector could be very large. The amendment has the potential to significantly increase the capital base of the private law corporation in a manner that would distort even further the normal means of capital formation in the private sector.

OTHER ISSUES RAISED BY H.R. 22

Market Tests

H.R. 22 would add a new Subchapter V to Title 39 to govern the subject of market tests to be conducted by the Postal Service. New sections 3751 and 3752

would allow the Service to freely conduct market tests of experimental noncompetitive and competitive products, respectively, that are anticipated to produce no more than \$10 million in total revenues in any year. For larger-scale market tests — with anticipated revenues not to exceed \$100 million — the Service would be authorized to conduct such tests under regulations to be established by the PRC.

The Commission endorses a two-tiered approach to Postal Service market tests, as well as the incorporation of limiting conditions and safeguards in the new subchapter. However, based on our experience with the dollar amounts in almost all Postal Service experiments, the threshold for the first tier may be too high. Moreover, it would be helpful to the Commission if some additional clarification were provided in the bill in order to forestall disputes in the rulemaking process and potential litigation over the intended operation of the new provisions.

For example, new sections 3751 and 3752 apparently intend to preclude market tests that would cause "unreasonable market disruption" either for competitive or noncompetitive products, while new section 3753 directs the PRC to consider "the public interest in preventing unfair or disruptive competition" in establishing regulations for larger-scale tests. It is unclear whether the cited language is intended to direct the Commission's deliberations to apply established antitrust standards of fair competition, or some different measures of competitive behavior and market effect.

A more basic consideration is the nature of the Commission's scrutiny of market tests intended by the new subchapter. Sections 3751 through 3753 provide for Commission orders that would cancel or terminate market tests if specified conditions are not met, within the ambit of authority provided in the amended PRC complaint provision, section 3662. Sections 3751 and 3752 allow the Commission's issuance of a

cancellation order "at any time." However, it is unclear whether a complaint lodged by an interested party is intended to be a pre-condition of issuing such orders, or when the Commission's scrutiny of market tests noticed by the Postal Service is otherwise intended to commence. If no prior review of Postal Service market tests is intended, as appears to be the case, it would be helpful if the timing and conditions under which the Commission should review ongoing market tests were clarified.

The Postal Service proposes amendments to the bill's market test provisions that would considerably loosen, or even dissolve, some of the limits and protective conditions incorporated in H.R. 22. The Service's amendments would eliminate the distinction between ordinary and large-scale market tests for experimental competitive products, replacing the \$10 million cap for the former with a uniform \$100 million limit. At the same time, the Service proposes to delete the protective condition that would preclude the introduction or continued offering of experimental products which "cause unreasonable market disruption." It does so on the grounds that this restriction is a "subjective criterion," and that, after all, introducing any new postal product will inevitably impact on market conditions, particularly if the new product is well-received.

Mr. Chairman, when I testified on the market test provision in H.R. 3717, I noted that:

First, it should go without saying that \$100 million per year is a huge amount of money for most businesses. Gross revenues of this magnitude, if achieved by the Postal Service relative to a single product or service, could seriously disrupt many existing markets.

This observation is as germane today as it was when I testified in July of 1996. Moreover, the Postal Service's rationale for its proposed amendments would appear to

confirm the anticipated potential for market impact. Apparently the Service doesn't want to have to worry about how its market tests are likely to affect conditions in pre-existing competitive markets, or to have Congress authorize the PRC to do its worrying for it.

We recognize the perceived need to equip the Postal Service to compete more effectively in today's marketplace, and that competing often means setting your sights on someone else's lunch. If the Postal Service is to be authorized to go after revenues of as much as \$100 million in a market test, we submit that some kind of oversight on competitive impact and fairness must be exercised. The alternative would be to leave affected competitors with no other recourse than a cumbersome private antitrust action in a Federal court.

For these reasons, we oppose the Postal Service's proposed amendments on market tests, and urge their rejection.

Qualifications of Directors

Directors are to be selected solely on the basis of their proven ability to manage organizations similar in size and scope as the Postal Service. We suggest that the subcommittee also consider other qualifications and thus expand the pool of talent from which selection could be made. Our first concern is that there are very few organizations similar in size and scope to the Postal Service in this country. In addition, we are mindful that the Postal Service is an organization that touches the lives of all Americans. Candidates that possess a wider variety of skills, experience, and exposure to different size organizations could provide valuable insight into the needs of all

citizens. Private corporations frequently tap educators, civic leaders, and consumer representatives, as well as business men and women, to serve as directors.

Bonuses

Bonuses to officers and employees of the Postal Service are allowed under § 3773 of H.R. 22. The implicit objective of the bonus program, to provide incentives to officers and employees to improve institutional performance, is laudable. We do, however, have some thoughts on several aspects of this program.

First, the amount of profits in a particular year establishes the maximum amount of money available for distribution as bonuses for that year. We recognize this maximum amount can be reduced to some extent by Commission findings, and limited by Postal Service decisions regarding other uses for the profits, such as the need to retire debt. Nevertheless, total annual profit is the starting point. We believe it improvident to make all profit available for distribution as bonuses. The Postal Service is an ongoing entity that operates in a dynamic environment. A more prudent course would be to reserve some portion of profits for modernization, emergencies, lower postage rates, or any number of other important business purposes. We recognize that H.R. 22 permits the Postal Service to retain profits for various purposes. But mandatory retention of some portion of profits would be a feature of the legislation that would assure that the Service would emulate the behavior of responsible parties in the business community.

An important related issue is the wisdom of using profit as the measure of the efficiency of performance of the Postal Service. The amount of profit in a particular fiscal year is sensitive to a large number of factors, many of which are outside the

control of the Postal Service. Events such as a labor relations work stoppage by a major competitor, extreme weather conditions, or even legislative actions, can effect the amount of profit in a year, plus and minus. Even more important is the strength of the national economy as evidenced by the strong growth in postal volumes and revenues during recent years. In addition, planned spending on needed programs may not occur. This could increase profits in one year to the longer-run detriment of the Postal Service. Moreover, a standard accounting convention could require that a prior year's adjustment, such as has occurred for worker's compensation, be totally expensed in the current year. In this instance, current year profits are impacted by circumstances or misestimates that actually happened in the past. This could result in an understatement or an overstatement of current period profit from the point of view of how well the Postal Service performed in the current year.

A possible solution is to loosen the connection between current year's profit and the amount of money available for bonuses. For example, an annual moving average of profits for a number of years might permit a fairer evaluation of Postal Service performance. There are undoubtedly other methods that would lessen the impact of one-time occurrences on current year's profit for purposes of determining the bonus pool and mitigate the influence of events that are outside Postal Service control during a particular year.

As an alternative to focusing on profits, we wish to suggest a system that incorporates productivity explicitly. The Postal Service total factor productivity (TFP) measure is a very sophisticated tool that takes into account many pertinent factors such as capital investment, skill level of the work force, and the changing workload content of the mail that has to be processed and delivered. This is an objective measure of institutional performance, and we suggest that this tool also be used to determine the

amount of funds available for bonuses. As an example, the pool of profits available for bonuses could be reduced if the change in TFP is small. If TFP is negative, even with profits, consideration could be given to prohibiting any bonuses at all. Linking the bonus pool to Postal Service productivity would mitigate the impact of the vagaries that impact profit, and more directly relate bonuses to performance. Such a system could also reward postal employees in a year in which losses are incurred for reasons beyond their control but in which productivity improved.

Judicial Review

In keeping with the new division of responsibilities between the Directors of the Postal Service and the Postal Regulatory Commission, section 202 of the bill amends current § 3628 of Title 39, which governs judicial appeals of final actions on rate and mail classification matters. The amended version of § 3628 appropriately provides for appeals of final PRC decisions establishing adjustment factors and product transfers between the noncompetitive and competitive mail categories. It also provides for appellate review of decisions of the Directors to approve, allow under protest, or modify PRC recommended decisions on mail classification changes, and on requests for establishment of new noncompetitive products.

The latter provision presents an opportunity to rectify an anomaly that has become apparent during the Commission's institutional history. Under the current wording of § 3628 — which the bill's amended provision preserves — decisions of the now-Governors to reject PRC recommended decisions with no further action are not explicitly appealable. This omission has provided the Governors with the equivalent of a "pocket veto" over Commission recommendations with which they disagree, and exercising this option can leave substantive recommendations — particularly

recommended mail classification changes — suspended in a limbo that offers no recourse to affected parties. The Commission recommends that this procedural void be filled by adding the words "reject without further action under § 3625" to the list of appealable actions of the Directors in amended § 3628(a).

On another matter, H.R. 22 clarifies the situations where the Department of Justice provides legal assistance to the Postal Service. In past litigation concerning issues that affect both the Postal Service and the Commission, the Department of Justice has balanced the concerns of our two separate agencies. We suggest that language should be added to this legislation to make it clear that where the Postal Service is representing itself the Department of Justice will still provide representation for the Commission.

Appeals under § 404(b)

Finally, I want to take a minute to thank the subcommittee for adding a provision to § 404(b) to clarify the period allowed for appeals of Postal Service decisions to close small post offices. As you know, the Postal Service is not currently pursuing a policy of closing offices. The Commission, nevertheless, has received a number of communications from individuals that indicate a problem may exist with the Postal Service exercise of its authority to suspend the operation of post offices in emergencies. The General Accounting Office did a report on this subject recently. The issue seems to be that in some instances the Postal Service does not act to replace or close a suspended facility for years, and this inaction leaves the community without service and effectively changes an emergency suspension into a closure without the procedures required in § 404. A remedy might be to allow interested persons to file an appeal of any suspension lasting more than 6 months.

Implementation of H.R. 22

The Commission's review of H.R. 22 has uncovered several areas where minor adjustments could be made to improve the smooth transition from current postal ratemaking to the price cap regime provided by the draft legislation. H.R. 22 calls upon the Postal Regulatory Commission to exercise review over numerous aspects of the transition. Each individual task assigned to the Commission is important, and feasible. However, the sheer number of tasks that must be accomplished during the first year of operation after enactment of the Postal Modernization Act of 1999 is quite daunting.

Attached as Appendix A to this testimony is a list identifying the rules that would have to be developed by the Commission, through open public processes, shortly after the legislation becomes law. Many of these obligations would have to be met within very short timeframes so that the Commission could exercise its review functions as required. While we understand the desire to move into the brave new world expeditiously, we suggest that a transition period follow enactment of this legislation so that the Postal Service, the public, and the Commission can conscientiously contribute to developing effective and workable implementing regulations and, thus, mitigate the amount of confusion and litigation.

CONCLUSION

Mr. Chairman, we realize our remarks today appear to be rather extensive. However, I have not addressed every provision in H.R. 22, nor even every significant amendment proposed by the Postal Service. We want to thank you again for the opportunity to present our views.

We will be happy to answer any questions you may have.

PRC ACTIONS TO IMPLEMENT H.R. 22 REQUIREMENTS

Required Rulemakings. *Most need to be completed immediately or by establishment of baseline rates.*

- Adopt regulations ensuring confidentiality of certain USPS information provided in reports or under subpoena—§ 3604(g)(3).
- Conduct notice-and-comment proceeding to determine net value of assets and liabilities attributable wholly or primarily to competitive products—§ 2011(j).
- Adopt regulations establishing a schedule and procedures for transferring non-postal products to USPS Corp.—§ 205(b)(2).
- Adopt regulations defining “commercial entity” to implement prohibition of certain USPS investments—§ 2011(d)(2)(B).
- Adopt regulations to implement the unfair competition prohibitions in § 404a—§ 404a(c).
- Adopt regulations specifying procedures for establishing adjustment factors (including “exigent circumstances” provisions)—§ 3733(b)(2)(B).
- Adopt regulations implementing cost coverage requirements for competitive products under § 3744(b).
- Adopt regulations providing procedures for extension and cancellation of market tests of experimental noncompetitive products [§ 3751(d) and (e)], and experimental competitive products [§ 3752(d) and (e)].
- Adopt regulations providing procedures for the conduct of large-scale market tests [§ 3753(d) and (e)].
- Adopt regulations applicable to proposed new competitive product introductions—§ 3763(c)(1).
- Adopt regulations establishing procedures for the transfer of products between the competitive and non-competitive categories under the requirements of § 3764(d).

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- Adopt regulations prescribing the form and content of reporting requirements applicable to the private "USPS Corp." for § 3772 purposes—§ 2012(g)(1).
 - Adopt regulations establishing content of Postal Service annual reports § 3772(c); for public comment on those reports § 3773; providing for PRC access to USPS and USPS/IG materials supporting USPS annual reports to PRC—§ 3772(d); and for regulations to initiate changes and improvements § 3772(e).
 - Adopt regulations providing for payment of judgments against USPS or U.S. Government arising out of USPS activities in the provision of competitive products—§ 2011(f).
 - Adopt regulations for consideration of proposed Negotiated Service Agreements—§ 3641(b).
 - Adopt regulations implementing "date of postmark" standard in § 404(b) appeals—§ 304(b).
 - Adopt regulations establishing PRC Office of Inspector General—§ 701(c).

Other new Commission activities during this time period.

- Conduct baseline rate case § 3721.
- Draft and submit Annual Report to President and Congress on PRC operations and USPS public-service costs—§ 3771.
- Draft and submit annual written compliance determination for rates, satisfaction of performance goals, and service standards for non-competitive products—§ 3773.
- Maintain and publish updated lists of products by basket § 3731(c) and competitive products § 3741(c).
- Report (as necessary, but at least every 6 years) to Congress on how system is working, with recommendations for change § 3774.

Mr. MCHUGH. Let me ask about the private law corporation. Before we do that, Commissioner Goldway has presented testimony which we will submit its entirety in the record. Commissioner, we thank you for that extra effort and welcome you, all of you, of course, but I believe this is your first hearing? Welcome. Be careful what you pray for, Commissioner.

[The prepared statement of Ms. Goldway follows:]

Supplemental Testimony

of

Commissioner Ruth Y. Goldway

Before the
U.S. House of Representatives
Committee on Government Reform
Subcommittee on the Postal Service

February 11, 1999

Chairman McHugh, members of the Committee on Government Reform, Subcommittee on Postal Service, I am submitting this testimony on H.R. 22, the Postal Modernization Act of 1999, as an individual statement of one Commissioner of the Postal Rate Commission and as an addendum to the testimony delivered on behalf of the full Commission by Chairman Gleiman.

I want to commend Chairman Gleiman for the careful, thorough and cooperative fashion in which he supervised the development of the Commission's joint testimony. His lengthy testimony does not reflect all of the concerns that arose during Commission discussions, but it incorporates the vast majority of our comments and the remarkable consensus we reached on a broad array of issues. In particular, I appreciate the Chairman's comments on the need to broaden the qualifications for membership on the Postal Service Board of Directors in order to assure that the public interest is well represented; his comments on the need to limit, in some fashion, the portion of profits that could go directly to bonuses; and his clear descriptions of the complex problems that could arise as a result of the establishment of the Private Law Corporation.

While I respect the hard work and several years of deliberation that have gone into the drafting of the current H.R. 22, as a relative newcomer to the field of postal services who has previously focused on the consumer's point of view, I may have a somewhat different perspective on postal reform, which I offer for your consideration.

During the economic expansion of the 1990s, consumers have experienced the turmoil and rapid changes of a highly competitive marketplace and, for the most part, they have greatly benefited. The forces of new technologies and deflationary raw material costs have combined with innovations in marketing, deregulation, mergers creating scope and scale economies, and fierce battles to gain market share so that consumers now have more and better quality goods and services available to them at lower prices. Likewise, H.R. 22 should rely more on the advantages of competition than on protecting the marketplace from possible Postal Service competition.

H.R. 22 should encourage the Postal Service to be more efficient and innovative. Its competitors would then have to respond and the public would get the benefit of lower prices and better services from all providers.

But §205's restrictions on the introduction of new products, except as part of a Private Law Corporation, limit the Postal Service's ability to be innovative and respond to changing technologies with new products. It is

inappropriate for legislation designed to prepare the Postal Service for the next century to prohibit it from providing services other than those specifically related to the physical delivery of letters, printed material or packages weighing up to 70 pounds.¹ Yes, new products can be offered by the Private Law Corporation, but, as the Chairman's testimony explains, the PRC has concerns about the construct and activities of such a corporation.

Therefore I would propose loosening the definition of *postal product* in H.R. 22's revised §102 to allow for product innovation where there is a nexus to postal operations, and where the Postal Service can show that the new product will benefit from Postal Service scale or scope economies. If the Postal Service can draw on such economies, consumers will benefit from lower prices.

We should not curtail the ability of the Postal Service to be innovative just because of its size. As the Supreme Court has said, "[l]ow prices benefit consumers regardless of how those prices are set, and so long as they are above predatory levels, they do not threaten competition."² Further, it has said, "[i]t is in the interest of competition to permit dominant firms to engage in vigorous competition, including price competition."³

Enhancing the ability of the Postal Service and its competitors to do battle fairly will have a beneficial impact on Postal Service productivity, industry competition and consumer welfare. However, enhancing competition in the postal industry should be a two-way street. To that end, I would ask the Committee to assess further the impact of other laws that may unfairly inhibit competition by Postal Service competitors. The Committee should consider decreasing the scope of the letter monopoly on a graduated basis, say over ten years, charging the PRC with reporting annually to Congress about such a provision's effects on universal service.

The rather elaborate and detailed statutory checks and balances built into H.R. 22's price cap mechanism will serve to protect mailers from cost shifting or sudden price increases. On the other hand, they provide little opportunity or incentive for the Postal Service to lower rates either to reflect the rapid impact of management efficiencies or to offer volume-attracting discounts. Lowering prices in a nondiscriminatory fashion (i.e., not NSA's) in a competitive market does not always mean cost shifting or predatory

¹ I would note that the 70-pound restriction would mean the Postal Service never could compete against its competitors for larger weight packages if it so chose. The current lack of Postal Service competition for 70+ pound package delivery is meaningful; private carrier rates jump dramatically just past the 70-pound mark.

² *Atlantic Richfield Co. v. USA Petroleum Co.*, 495 U.S. 328, 338 (1990). See also generally *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209 (1993).

³ *Id.* at 341, citing prior cases for the same proposition.

pricing, and such reductions can be a way for the Postal Service to attract new customers. Lower prices could, in themselves, be powerful incentives for the Postal Service to increase productivity and directly benefit consumers. Therefore, I am inclined to support that section of the Postal Service's price cap proposal which broadens the definition of products to current subclasses -- *as long as* H.R. 22 also includes an amendment requiring the Commission to review and adjust the baseline rates every five years. Such a regular quinquennial review would provide a public forum in which imbalances resulting from the price cap mechanism, on the high or low end, could be examined and corrected.

In this same vein, I would be inclined to allow the Postal Service broader discretion in its market tests for postal products than H.R. 22 currently allows *as long as* at the midpoint of the trial the PRC was required to review the ongoing test to determine that the resources allocated to the test were not unduly disproportionate to the revenues derived and the PRC could cancel the test if such a finding was made.

Finally, while I would appreciate the Subcommittee's consideration of these possible adjustments expanding the Postal Service's ability to compete with other providers with regard to prices and new products, I think it is vital that the Postal Service be required to present its products and services to consumers in the marketplace under the same terms as its competitors. To that end, I am concerned that H.R. 22 does not subject the operations of the Postal Service to federal laws and regulations concerning deceptive advertising. Recently, the Commission held in the *Life Time Fitness* complaint case that the Postal Service's use of language in a marketing diskette for advertising mail was "deceptive and inappropriate."⁴ Nonetheless, the Commission found it necessary to dismiss the complaint because of limitations on its complaint authority.

H.R. 22 may not subject the Postal Service to the review of any regulatory agency for deceptive practices. The Federal Trade Commission is the agency primarily charged with prohibiting deceptive acts and practices,⁵ but FTC jurisdiction over Postal Service operations is problematic. Section 401(1) of Title 39 permits the Postal Service "to sue and be sued in its official name," but FTC jurisdiction extends only to a corporation "which is organized to carry on business for its own profit or that of its members . . ."⁶ Although the "break even" standard currently found in 39 U.S.C. §3621 would be

⁴ Docket No. C98-1, *Complaint of Life Time Fitness*, Concurring Opinion at 1, issued January 27, 1999.

⁵ See 15 U.S.C. §45.

⁶ 15 U.S.C. §44. See *Community Blood Bank of Kansas City Area, Inc. v. FTC*, 405 F.2d 1011 (8th Cir. 1969) for one decision explaining the scope of FTC jurisdiction over corporations.

deleted by H.R. 22, it is unclear whether all Postal Service operations would be considered to be of the type covered by FTC jurisdiction. Further, one can read §307, which amends §409 of Title 39, as specifically excluding the FTC from policing Postal Service advertising and marketing practices.⁷

Nor is there readily apparent Commission authority over deceptive practices. H.R. 22 expands the Commission's complaint powers, but there is no specific reference to deceptive practices. For example, revised s 3662 of Title 39 would allow interested parties to file a complaint with the Commission if they believe that "the Postal Service is not providing postal service in accordance with the policies of this title," but there is no specific policy in Title 39 directed against deceptive advertising. And, as the *Life Time Fitness* case suggests, even under current law, the regulated side of Postal Service operations needs this kind of oversight.

Once again, thank you for the opportunity to share these additional comments. I look forward to further participation with my fellow Commissioners as the legislative process for H.R. 22 proceeds.

⁷ Proposed 39 U.S.C. §409(d)(1)(C)(ii) applies FTC antitrust jurisdiction to certain aspects of Postal Service operations. In applying 15 U.S.C. §45 to the Postal Service, it specifically includes only the FTC's "unfair methods of competition" authority.

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

RUTH Y. GOLDWAY
COMMISSIONER

March 8, 1999

The Honorable John McHugh
Chairman, Subcommittee on the Postal Service
Committee on Government Reform and Oversight
U.S. House of Representatives
2157 Rayburn House Office Building
Washington, D.C. 20515-6143

Dear Chairman McHugh:

I wish to supplement my written testimony of February 11, 1999, on H.R. 22, which I provided as an individual statement of one Commissioner on the Postal Rate Commission. Among other things, I had expressed the concern that H.R. 22 did not subject the Postal Service to federal laws and regulations concerning deceptive advertising. Subsequently during a discussion of H.R. 22 at the Commission for which subcommittee staff was present, a suggestion was raised that H.R. 22 as currently written would give the Federal Trade Commission ("FTC") jurisdiction over any deceptive advertising by the Postal Service. This suggestion was grounded in language contained in proposed 39 U.S.C. §409(d)(1)(C)(ii), which defines the Postal Service as a "person" subject to "section 5 of the Federal Trade Commission Act (15 U.S.C. 45) to the extent that such section 5 applies to unfair methods of competition." I wish to expand upon my written testimony to clarify why FTC jurisdiction is problematic with H.R. 22 as currently written.

First, §409(d)(1) only covers conduct "with respect to any service which is not reserved to the United States under section 1696 of title 18" A substantial amount of the Postal Service's activities are still protected by the letter monopoly statutes.

Second, FTC jurisdiction extends only to a corporation "which is organized to carry on business for its own profit or that of its members" ¹ The "break even" standard currently found in 39 U.S.C. §3621 would be deleted by H.R. 22, but it remains unclear whether all Postal Service operations would be considered

¹ 15 U.S.C. §44. See *Community Blood Bank of Kansas City Area, Inc. v. FTC*, 405 F.2d 1011 (8th Cir. 1969) for a landmark decision explaining the scope of FTC jurisdiction over corporations.

to be of the type covered by FTC's "for-profit" jurisdiction because the scope of the FTC's "for-profit" jurisdiction is controversial.²

Third, H.R. 22 only subjects the Postal Service to FTC jurisdiction "to the extent that such section 5 applies to unfair methods of competition."³ Thus, H.R. 22 specifically excludes FTC jurisdiction regarding "unfair or deceptive acts or practices"⁴ As a matter of course, the FTC brings its antitrust cases under its "unfair methods of competition" authority.⁵ The "unfair or deceptive acts or practices" phrase gives the FTC authority over deceptive advertising, and it is under this standard that it has brought its modern false advertising cases.⁶ Congress added the "unfair or deceptive acts or practices" phrase under the so-called Wheeler-Lea Amendment to the FTC Act in 1938 precisely because questions had arisen in court rulings about the ability of the FTC to protect consumers under its "unfair methods of competition" authority.⁷ The Wheeler-Lea Amendment was adopted as a way to remove the requirement that the Commission prove competitive injury in its false advertising cases and to "set the stamp of legitimacy on its consumer protection activities"⁸

² A recent case discussed the differing views of the circuit courts of appeal on such jurisdiction. See *California Dental Ass'n v. F.T.C.*, 128 F.3d 720, 725-26 (9th Cir. 1997). The Supreme Court is reviewing the *California Dental* decision, and according to United States Law Week "the definition of 'profit' – the trigger for Federal Trade Commission jurisdiction over trade associations – was a focal point of discussion during oral argument before the Supreme Court last month." 67 U.S. Law Week 3503 (February 16, 1999).

³ Proposed 39 U.S.C. §409(d)(1)(C)(ii).

⁴ 15 U.S.C. §45(a)(1).

⁵ See, e.g., *F.T.C. v. Motion Picture Adv. Co.*, 344 U.S. 392, 393 (1953).

⁶ See, e.g., *F.T.C. v. Pantron I Corp.*, 33 F.3d 1088, 1095 (9th Cir. 1994). For example, the FTC has noted that it "regulates food advertising under its statutory authority to prohibit deceptive acts or practices under Section 5 of the FTC Act." *FTC Enforcement Policy Statement on Food Advertising* (May 1994), at 4. The full ambit of FTC deceptive advertising authority is further explained in its so-called Deception Statement. See *Cliffdale Associates, Inc.*, 103 F.T.C. 110, 176 (1984), reprinting as an appendix a letter dated Oct. 14, 1983, from the Commission to the Hon. John D. Dingell, Chairman, Committee on Energy and Commerce, U.S. House of Representatives.

⁷ Section 5 of the FTC Act originally prohibited only "unfair methods of competition." FTC Act of 1914, ch. 311, §5, 38 Stat. 717. The "unfair or deceptive acts or practices" phrase was added by the Wheeler-Lea Amendment of 1938, ch. 49, §3, 52 Stat. 111 in response to the Supreme Court's limiting decision in *F.T.C. v. Radlam*, 283 U.S. 643, 649 (1931).

⁸ See Neil W. Averitt, *The Meaning of "Unfair Acts or Practices" in Section 5 of the Federal Trade Commission Act*, 70 Georgetown L.J. 225, 231-35 (1981).

It should be noted as well that any residual authority the FTC might have to bring false advertising cases under its "unfair methods of competition" authority is clouded by H.R. 22's specific exclusion of FTC jurisdiction regarding "unfair or deceptive acts or practices" And certainly the FTC's lack of authority over not-for-profit organizations makes jurisdiction over the entirety of Postal Service operations highly problematic absent specific Congressional authorization.

If H.R. 22 is to be amended to grant the FTC authority over Postal Service unfair or deceptive acts or practices, including those that may occur under the mail monopoly, as I believe is both warranted and the intention of your subcommittee, the most unambiguous way to accomplish this would be to add an additional subparagraph to 39 U.S.C. §409 (perhaps as subparagraph (i)) specifying that the Postal Service shall be considered to be a "person" for purposes of section 5 of the Federal Trade Commission Act, 15 U.S.C. §45(a)(2), to the extent that such section 5 applies to unfair or deceptive acts or practices.

Sincerely,



Ruth Y. Goldway, Commissioner
Postal Rate Commission

cc: Honorable Chaka Fattah

Ms. GOLDWAY. Thank you

Mr. McHUGH. I am aware, Mr. Chairman, that you have concerns about the private law corporation and we do need to probe those and discuss them. But, first, let us spend a little time on the Postal Service amendments. A great deal of your prepared testimony was spent, I felt, in addressing those issues.

Now, you heard me discuss, for example, the cost coverage rule, the 5 year sunset of that, and the suggestion by the Postal Service that they be the determiners of what is non-competitive and competitive, versus the process defining H.R. 22, involving more market oriented procedures, and such.

Let's spend a little time, if you would, filling out the record in a counterpoint, for lack of a better description, of what the Postmaster General just said. Let's start with the cost coverage rule.

I know you heard my comments, the concerns about doing away with that provision after 5 years. You heard in response both the PMG and the General Counsel's view about a future of the Postal Service and a process by which, after 5 years, that cost coverage rule becomes moot, in their view, at best, and at worst becomes a negative thing in terms of a pricing burden on a product that in theory is supposed to be competitive. I'd like to hear your views on that.

Mr. GLEIMAN. Well, first let me say that, as I recall, H.R. 22, as reported out of the committee last fall and as reintroduced this year, does contain a provision that allows the Postal Service to approach the Postal Regulatory Commission and ask for adjustments in the nature of the equal contribution provision. So, to the extent that something is going to happen over the next 5 years, or however many years, that could impact negatively, there is a mechanism built in now.

The big problem with the Postal Service's proposal to sunset the contribution requirements on the competitive side has to do with where the money to cover overhead is going to come from. There is an issue that we've all been wrestling with about when the first class monopoly volume is really going to decline. And one of the reasons that we're all involved in this and have been for a number of years is the fear that we need some way to cover overhead costs.

The Postal Service's proposal that in 5 years there doesn't have to be any contribution rule, or any contribution for that matter, would indicate that we're not going to be able to solve the problem associated with declining first class volume. Even assuming that the Postal Service is positioned to shed volume variable costs, it will still have substantial fixed, overhead costs that it will have to cover. I don't know where it expects that money to come from, if it doesn't expect, in year 6, for the competitive products to make some contribution. But doing away with the mark-up is exacerbated in a sense, as are several other provisions of the bill, by the Postal Service's proposal to define product at the subclass level. If all you have to do is cover costs at the subclass level, and you don't even have to make a contribution, just think about what happens with offerings or rate categories within a particular subclass. Where they think they've got something close to market dominance, which they can have under their proposal in the competitive area, they would be encouraged to go for higher rates and maybe

below costs rates for subordinate units, as the bill calls them. And I think that there is potential for a great deal of hanky-panky.

Ms. Elcano, as I understood her, said, "Don't worry about it, there are provisions in here which apply the anti-trust laws." Well, you know, a lot of the Postal Service amendments would weaken the antitrust protections and the other playing field leveling provisions that you have included in H.R. 22. And even assuming that she's right, anti-trust suits take 1½ years, 2 years, 3 years, I don't know. I have a law degree, but I haven't been to court in an anti-trust case.

I imagine that with the opportunity not to have to worry about marking up your products and only covering costs, and then having some sub-units where you could be below cost, that you could do some fair damage to the private sector.

Mr. MCHUGH. Also, let me say, when I address my questions to the chairman they are by inference addressed to any of the commissioners. If any of you at any time want to add or expand upon anything that the chairman is saying, please feel free to do so.

Mr. GLEIMAN. You'll be disappointed to know that Vice Chairman LeBlanc has laryngitis today and probably won't be able to offer additional comments.

Mr. MCHUGH. I'm heartbroken. Well, I wish you a speedy recovery sometime later this afternoon. You also heard the response to the concerns that we have heard that I conveyed to the PMG, with respect to their amendment that would propose that they define competitive versus non-competitive.

You may have also heard the general counsel's response with respect to single piece international mail and the fact that they have a court case going now. And that again in the future they envision a time when it would indeed be competitive. Do you view that amendment as a helpful one or as one that better balances the playing field, as we like to say, in this process?

Mr. GLEIMAN. I do not think it better balances the playing field. I also heard the Postmaster General comment at another point in his presentation, in response to a question that you asked, that almost every Postal Service product, or something to the effect of, has competition in one way, shape or form.

As for the argument that there is something in a lawsuit somewhere that may imply that single piece international should be in competitive, I guess you could extend that argument and say that, well, letter mail, which is part of the monopoly, is in competition, we've all heard it time and time again, with evolving technologies.

Everybody is worried about electronic bill paying, so why don't we just move everything into the competitive basket or the competitive side of the ledger and get it over with now? That's how I would read the Postal Service's position. I just think it's not well taken.

Mr. MCHUGH. You have, and let me state for the record, in the body of your testimony a series of amendments that you suggested that, in your opinion, could make the bill more "finely tuned," to use your phrase.

I will respond that, just at first blush, many of those amendments did indeed appear to be some things that we not only can, but should and will, take under consideration. I won't go into a list

of those now, but we undoubtedly will want to get back to you on ensuring that, as we go forward, we're formulating something that you indeed intended and envisioned, and I appreciate that.

Mr. GLEIMAN. Mr. Chairman, perhaps I should have said this at the front end, but Bill Henderson talked about the relationship between the Postal Service and the Postal Rate Commission in the past few years, and he was right. It's a much better relationship than it has been during many years since postal reorganization in the early 1970's. A lot of that has to do with Bill Henderson's attitude.

I think it's important for you to know that we talk with the Postal Service frequently about the bill. They initiate the conversations. We initiate discussions with them. We don't always agree with them, but they have a perspective that they need to present, and I understand that where one sits is where one stands on issues.

I think it's important for you and for everyone else who is involved in this to understand where the Rate Commission sits. It is an interesting place because we, and you can take me at my word, are not presenting views which are intended to perpetuate a bureaucracy.

Our concern is that whatever comes out in the way of H.R. 22, if and when it's enacted into law, is good for the American public, the mailing public, the Postal Service. Our amendments and the proposals that we offered, as well as our critique of the Postal Service amendments, are all offered in that vein.

Mr. MCHUGH. I do take you at your word. I do take it not just as your word today, but, in some of your previous testimony, some of your frankest observations have been with respect to what you view as the possible inability of the PRC, under the current structure, to do a task that was being envisioned. That's a very frank assessment.

I took from that, as you just noted here today, that your overriding interest is that whatever we craft is, when taken together, better than what we have today and continues to provide the kind of postal service that Americans have come to expect and to enjoy. But I certainly understand and appreciate your comments.

I was speaking about some of the suggested amendments that you had made and how we felt there was some room to move on a number of those. One of the suggestions that you made is with respect to work sharing discounts. You spoke about how you felt there was the need to put in language that somehow stipulated that work sharing discounts should only be allowed when there is a cost savings realized.

Understanding right now that that is the motivator of work sharing, explain or expand, if you will, a bit on why it is your concern that the Postal Service may find itself in the future doing work sharing agreements that don't result in cost savings. I mean, it seems to me it's kind of a sine qua non of the process. How does it get turned around?

Mr. GLEIMAN. Well, if you are interested in retaining volume that you have and or competing with, whether it is Deutsche Post, the Royal British Post Office, UPS, or Federal Express, you might be moved to provide discounts which are in excess of what is appropriate under certain economic considerations.

One of the principles, I think, that underlies this effort that you've undertaken is that we have an efficient system. I use the economic concept, efficient component pricing, in conjunction with the discussion of work sharing discount.

What we're talking about here is that the Postal Service, should offer discounts that reflect the costs that are avoided as a consequence of work sharing—not more and not less. That's what we strive for under the current ratemaking process, 100 percent pass through of cost avoidances. If the Postal Service sticks to that then mailers, users of the mail, are in a position to make decisions based on the economic dollars and cents.

If the Postal Service passes through 100 percent, and I can do it cheaper, then I'm not going to use the Postal Service. That's good for the overall economy. If I can't do it cheaper, then I am going to use the Postal Service, and that's good for the overall economy too, as well as for the Postal Service. So we think it's a very important concept that ought to be specifically included in the legislation.

Mr. MCHUGH. So you are simply concerned about, in the competitive area, volume and not losing volume at any cost to a potential competitor?

Mr. GLEIMAN. You could have work sharing discounts in the non-competitive area, both monopoly and non-monopoly non-competitive areas. I think that it's a concept that should be applied across the board. The Postal Service could, for example, introduce a drop ship discount for First Class Mail which does not now exist.

One would assume that the sensible thing would be to have a discount that reflects the costs that are avoided as a consequence of mailers drop shipping. I don't see any good reason for the Postal Service to offer larger discounts but, theoretically, they could under the price cap scheme. I don't think that they should. It would not be an efficient thing to do.

Mr. MCHUGH. In a similar vein, NSAs. Under H.R. 22, there is a prior notification requirement to the PRC, et cetera, another one of the amendments that the Postal Service has submitted. I did not raise this question directly to the PMG, but we will submit it in written form—that they would delete that prior PRC review.

The question I would have for you is, what would the effects of that be in your judgment, good or bad or indifferent? Assuming you are concerned about the loss of that provision, could something like a public notice, even without PRC prior review, take care of some of those concerns? Or is there some other role that we could develop for the PRC that might make the Postal Service's amendment, in your view, more workable?

Mr. GLEIMAN. I think at the very least there has to be public notice. What the Postal Service is proposing is to have something akin to secret, non-tariff rates. The bill, H.R. 22, provides an opportunity currently for parties to raise questions about negotiated service agreements. If they are secret, how are you going to know whether to raise a question?

If they are secret and you are similarly situated to the party that the Postal Service is dealing with, and the bill provides that the NSA should be extended to similarly situated mailers, how are you

going to know that there is something that, you want that somebody else is already getting?

So I think at the very least there needs to be public notice in advance. I mean a full public notice so that others can understand what it is that they might want to go after themselves.

Mr. MCHUGH. Well, is the "very least" good enough? I hear what you are saying and you feel that that's an absolute necessity, but where is your comfort zone?

Mr. GLEIMAN. Well, my comfort zone is with the bill. I suspect we could live with a little less, as long as everybody understood there was an after-the-fact review; and, that there were, indeed, liquidated damages provisions that could be enforced in the event that the Postal Service either noticed, or didn't notice, an agreement to the public that was a poor agreement and/or where the other party to the agreement did not live up to its end of the bargain. But I would much prefer the provision in the bill.

Mr. MCHUGH. How long a period of review do you think is necessary by the PRC? In other words, if the bill were to mandate a certain review period, do you have an idea what that timeframe might be?

Mr. GLEIMAN. That's a tough one because we're getting into a new area and there are some underlying questions. The thinking at the Postal Rate Commission has evolved substantially on negotiated service agreements. Whereas we had some really serious reservations before, our reservations are somewhat limited now.

But there are issues involving how the negotiated service agreements would be costed out; whether the costing would be bottoms up, subclass costing, or whether it would be a tops down cost avoidance approach. This is what is used now in ratemaking. Those issues have to be discussed in order to determine how long it is that we need to review an agreement.

The other issue is, who knows how many agreements there are going to be? Just like the Postal Service wants flexibility, I guess we would like a little flexibility on this one, too.

Mr. MCHUGH. Fair enough. Going back to an original question, and just so I've got it on the record, and I think I could deduce it from the previous answer. But, is my assumption correct that you would not agree that, under the current system, international Aunt Minnie mail ought to be competitive?

Mr. GLEIMAN. I think the bill has it split up right on that one, as it stands. We do have some questions, though, about some aspects of priority mail. If you use the market dominance test as a determinant, what goes into the competitive arena? It appears to us, although we don't know for sure, and we would have to have some information to look at to make a better determination, it looks to us as if in some areas the Postal Service may have what's tantamount to market dominance.

So while I like most of what is in the bill, in terms of how it has split up competitive and non-competitive, I think that we all, the committee, the Postal Service and the Postal Rate Commission have to look a little bit more carefully at these fairly large service offerings like priority mail.

Mr. MCHUGH. Well, that's what you like about the bill. Let's go to something that you may not find, you do not find as attractive,

and that's the provisions of the private law corporation. Rather than form a leading question, I'd like to just allow you the opportunity to kind of define or describe your view and your position, and maybe we can go from there.

Mr. GLEIMAN. I don't want to hog the microphone, and I would invite my colleagues to jump in at any time on this.

Mr. MCHUGH. Especially if they disagree with you on this one, I would urge them as well.

Mr. GLEIMAN. As I recall, when we first started talking about postal reform, and this may have been before you arrived on the scene, although it was mostly talk and no action before you arrived on the scene, there were a couple of problems and concerns that people had.

One of the concerns was expressed by the private sector, which felt that the Postal Service was embarking on non-postal activities and was using monopoly moneys to underwrite their forays into these new non-postal areas. Some of these activities had no nexus whatsoever to anything postal. So the question was: How do you make sure that there is a level playing field and that a monopoly is not there as the underwriter?

The other big concern was that—let me step back a minute. The Postal Service felt, and many large mailers supported them, that it had to get involved in non-postal activities because that was a source of new revenue. We all know the Postal Service is going to need new revenue to underwrite its universal service obligations when First Class Mail volume, and perhaps other mail volumes, flatten out or decline.

Now, let's look at what we've got. We've got a private law corporation, which I believe was intended to address those problems by helping out on the finance side of things. There is no requirement, and I want to emphasize "requirement," because I know there is a provision saying something can happen, but there is no requirement that if the private law corporation is wildly successful and makes a lot of money, that it has got to feed any of that money back in to underwrite the universal service obligation.

We recommend that if you do go ahead with the private law corporation, than at the very least there be a requirement that if the corporation make money, that money be paid back to the Postal Service to underwrite the universal service obligation—to deal with the problem we all know is 3, or 5, or 10 years down the road.

On the product side of things, we have the monopoly in a position where it's going to indirectly fund non-postal products. By the way, it's not altogether clear the Postal Service will ever make any money with non-postal products. The track record, as evidenced by a GAO report prepared for you, indicates that the Postal Service is not all that strong when it comes to getting out there and competing in a non-postal area.

The money for the private law corporation, in the bill, comes from the competitive product fund. The fund can transfer excess contributions or surpluses, after the equal contribution requirement is met. That's not all that bad. It certainly is an improvement over the current situation. But it appears as though the Postal Service wants to take PLC funding much further.

And even before you get to the Postal Service amendments, there is a discussion—and these discussions have taken place at the staff level and higher between the Postal Service and the Rate Commission, the committee is aware of them—of mechanisms for funding the private law corporation.

For example, there has been a suggestion that one thing you can do when you distribute the assets to the competitive box and the non-competitive box, is have the competitive side sell its assets and lease them back. Then you can take the revenue that the competitive side has earned from selling its assets to the Postal Service's non-competitive side, and use this money to further fund the private law corporation above and beyond what I think your bill initially considered, which is that surplus in the competitive fund.

Now, along comes the Postal Service, and the Postal Service wants to sell stock to the public. I suspect that if stock is sold to the public, that the stockholders are going to put pressure to be paid dividends, which is going to lessen the likelihood that any moneys are going to flow back over the fence to the Postal Service side. You know, it just gets very dicey.

Probably most troublesome, by the way, is the question a moment ago about the sunset after 5 years of the equal contribution provision. The Postal Service doesn't say that it's not going to mark up competitive products. It just says that it does not want to have to be worried about making a contribution over to the Postal Service side. It wants to have all the money that it makes on competitive products, both related to the cost of the products and related to any mark-up over the cost of those products, to be transferred into the private law corporation.

Step back to another Postal Service amendment. The Postal Service wants to be able to transfer whatever it wants, without regard, over to the competitive side. Anything that's not monopoly can go over to the competitive side. So you are left with First Class, Standard A letters, and a few other little things, that are covered by the monopoly. Everything else goes over into the competitive product area. Then you take all the money you make in a competitive product area, and you throw it over the fence into the private law corporation.

I thought we were all concerned about the monopoly captive audience. I thought we were all concerned about doing something to ensure that we were going to be able to meet the universal service obligations. The Postal Service's amendments seem to indicate that it is not all that interested in that, that it is more interested in the competitive aspects of this and in the private law corporation aspects. In terms of, you know, the financing has evolved, the role has also evolved.

I thought that you wanted them to be able to undertake some activities again in the non-postal area. Now the feeling is that it could transfer postal products. You could read the bill to allow the Postal Service to transfer everything, and I do mean everything, including the monopoly products, over the fence to the private law corporation.

The bill says that the Postal Service has an obligation to meet this universal service obligation. It does not say that that Postal Service has to have letter carriers, it does not say that the Postal

Service has to have mail handlers, it does not say that the Postal Service has to have clerks to collect, process and deliver that mail.

The private law corporation provision is, and this is a constructive criticism, please understand, it is written in a manner which would allow the Postal Service to contract with the private law corporation, which is not obligated, by the way, to use union labor, to perform all the functions that are necessary to fulfill its obligation, leaving you with a hollow virtual Postal Service, if you will; a couple of floors at 475 L'Enfant Plaza where there are some contracting officers; a few policy people; maybe somebody to come up and testify occasionally. Those are some of the concerns that we have.

But, again, when it comes to non-postal products, the private law corporation in the narrow sense is a better approach than what we now have, where there is a free ride on the back of monopoly revenues.

Mr. MCHUGH. Well, I won't say it sounds like a chapter in the X files, but you've thought the line out to—

Mr. GLEIMAN. It may be a chapter from the X factors, though.

Mr. MCHUGH. Flashback.

Mr. GLEIMAN. I think that the comments that we've made are fairly far reaching. But we've also noted that the private law corporation first appeared in H.R. 22 when it was marked up last fall. This is the first time there has been a hearing where anybody has had an opportunity to comment. In this set of hearings, it's the first time anybody will have had an opportunity to really talk about H.R. 22's private law corporation provision.

I take you at your word when you have said repeatedly that this is a work in progress. We would like to see it progress, but we would like to see it progress in a manner which is going to deal with the problems that we all thought we were trying to deal with at the outset.

Mr. MCHUGH. Your point on the first opportunity is correct. A lot of what you said is a fundamental, or I should say a philosophical, question, much like is there cross subsidy or not. We could argue or discuss for quite some time. As I know you understand, the current system has no requirement that there be clerks and postal delivery people. Indeed, if you turn to some of the gentlemen behind you, I think they would readily voice concerns about what they view to be the privatization in place, if you will, already of many traditional postal services through contracting out and such. So I don't know as I would agree we may not be solving that problem, but I don't agree we'd be creating it anew here.

Mr. GLEIMAN. Mr. Chairman, what the bill does is put the imprimatur of law behind contracting out. You are absolutely right. It's not prohibited under current law, but there is nothing under current law that can be read point blank to endorse that type of activity. I think there are reasonable people who will read the provisions and assume that it says this is OK.

But, you know, I think that the real issue here is taking a couple of steps back and asking the question, does the Postal Service really have to be involved in non-postal activities? The only reason I raise this is because we're all concerned, I think, about finding a way to make sure that we have a Postal Service that has sufficient

funds, in the face of declining volume at some point in the future, to continue to provide the services that the ranking member talked about earlier.

Mr. MCHUGH. The necessity in a political world to craft a bill that can be passed and signed into law, and a bill that tries to, as effectively as it can, respond to the very legitimate concerns of corporate America and private enterprise that feel that indeed under the current structure they are being asked, totally contrary to their philosophical view of capitalism in the longest lived democracy in the history of the world, to compete against a highly subsidized one in terms of government monopoly. And that's the challenge we have.

I want to just go back to the point about what H.R. 22 does or does not do. Without rejecting out of hand your interpretation, I would suggest again that practice has shown that the current structure has no prohibitions against privatization, and it is being done. H.R. 22 does in no way expand upon what currently exists in that regard, notwithstanding your concerns and not discounting your concerns.

But I don't want any one to leave this room under the impression of a point that I don't think you are making. There is nothing explicitly in H.R. 22 that calls for or in any way expands upon current law. I understand the point you've made twice now, but let me just add a couple of other things.

One of the other intents of the private law corporation, beyond those you described that talk about the monopoly underwriting the competitive or non-postal activities, the need to provide opportunities in the future for the Postal Service to add to its current fiscal structure through non-postal opportunities, but it was also to try to shield captive rate payers from the current practice where they and they alone are the financial carriers of any kind of ill-advised experiment in non-postal products.

You mentioned very accurately, and I think we all know this through our own experience, but as the GAO report, as you said we requested, recently illustrated, the track record of the Postal Service on these non-postal products in terms of the economics of it, and they would argue, by the way, we've not had a long enough history of it, there are many other reasons for it but, nevertheless, the picture as it stands today has not been positive. Those failures have been, would you agree, have been borne totally by the captive rate payer?

Mr. GLEIMAN. There is no question about that. Let me repeat again what I said before, and what is in our testimony. In that regard, H.R. 22 is an improvement over current law. It shields, to a degree, a monopoly player from bearing a burden of allowing the Postal Service to get involved in non-postal activities. Also, as there are no requirements today that postal employees be unionized, there is no prohibition in H.R. 22 that any future activities they would do through the private law corporation would not be unionized.

Mr. MCHUGH. And I suspect that when as H.R. 22 requires the shareholders and the sole interest in the private law corporation must be held by the U.S. Postal Service, that when our union friends go to the bargaining table in 2008, the year after I said if

we had started today H.R. 22 would be in effect, they might indeed be talking about the activities of the private law corporation to the CEO and chairman, who I assume would be the Postmaster General, about the opportunities for union employees in the private law corporation.

Mr. GLEIMAN. I'm sorry, did I—I don't know whether I understood you just now—

Mr. MCHUGH. Good, because I didn't understand a lot of what you said either. What I'm suggesting is there is nothing in H.R. 22 that would preclude—you mentioned there is nothing that requires employees that they hire be union. And I said there is no requirement for that currently on the baseline within the Postal Service. And in the comment I said there is nothing that would preclude, under H.R. 22, any employee hired under the private law corporation to in fact be union.

And that I suspect, and this is based only on about 15 years of experience in negotiating various employee contracts at both the State and Federal level, that when the union representatives for the more than 700,000 union employees of the Postal Service would go in and talk to the Postal Service management, who also would be the representatives of the sole stakeholder in the private law corporation, they might talk about hiring union employees as part of the private law corporation. Not that there would be any direct fiscal link or legal link, but I bet that would happen.

So all I'm suggesting is, I don't know as it is a valid critique—it's valid but I don't know as it's relevant to say there is nothing that would require those employees to be union, other than to get the attention of the first row here [indicating union representatives].

Mr. GLEIMAN. Mr. Chairman, all I'm suggesting is that this is a new concept that was added to a bill that was marked up last fall. It has not been examined in great detail in public. I think there is ample opportunity for people to agree with you and/or with me. What I think is necessary, and what we said in the written statement, is that we think that there needs to be a careful and thoughtful examination of just what's intended. I go back to my original point: If the private law corporation, whatever it does, is not going to provide sufficient revenues, and those revenues are not required by the bill to be plowed back into the monopoly side or the non-competitive side, then I'm not sure what useful purpose the bill serves.

You said the purposes were opportunities to add to the current stable of products and develop new funds and to shield the monopoly. I don't disagree with you. I just think that we have to look at the realities of the situation and some parts of the bill as drafted. If we want the money that the corporation may make, whatever you ultimately decide it should be allowed to do, to benefit the monopoly, then we ought to have a requirement to that end.

We ought to have some checks and balances to make sure that if those Postal Service amendments are accepted, that the Postal Service hierarchy doesn't just use the Postal Service as a cash cow to fund the private law corporation. It's down to that. I assume we'll have some discussion. I would like to think we'll have some discussions about it.

Mr. MCHUGH. We will. And your points are excellently taken. So to sum up on that issue. You are concerned about the permissive nature of H.R. 22 which permits, allows for, a contribution back. You feel it would be more appropriate if there was some sort of requirement of a contribution back. I'm not terribly troubled by that component. What the challenge then becomes is, how do we do that percentage, based on what determination? So we need to talk.

Mr. GLEIMAN. Please listen carefully. This may be the only time in my life I ever give a one word answer. Yes.

Mr. MCHUGH. Good. I would be happy to yield to the ranking member, Mr. Fattah.

Mr. FATTAH. Thank you. I'm at somewhat of a disadvantage. I told you I had Secretary Riley over in the other room. But let me thank you for coming forward. And, as I understand from your written testimony, and I wasn't here for some of the back and forth, well, let me ask you like this. The price cap issue, your position on that is what? And it doesn't have to be one word, but brevity is helpful.

Mr. GLEIMAN. I think with some fine tuning the price cap approach can work. There are a couple of issues that I think need to be dealt with. We understand and feel that the price caps would be set at the rate element level—the rate cell level, excuse me. Most of us think that this is an appropriate place to set the price caps.

The Postal Service feels it should be done a different way. We disagree with them. The way they would propose it, to set it at the subclass level, would allow for below-cost pricing under the subclass. We don't think that's consistent with one of the basic premises of the bill, which says everybody ought to pay his cost.

The Postal Service also proposes some modifications to the nature of price caps. And these modifications are a bit troublesome in that they would provide for larger increases. Now, when this question was asked, and I can't recall whether it was you or one of the other Members who asked the question of Mr. Henderson, the response was that, well, when it comes to the first basket, First Class letter mail, don't worry, we can't go over the price cap. And that's right. They've set a band of 2 points below the price cap and zero above, but they've only set that for First Class letter mail, the Aunt Minnie basket. When it comes to baskets two, three and four in the Postal Service proposal, which has business First Class Mail, and has Standard A mail, and periodicals, the Postal Service has given itself a bit more discretion. There it says that prices can go up as much as 1½ points above the cap.

If you use an example, and I don't want to confuse anybody with this, but if you assume inflation is 3 percent, and then under the proposal in the bill the Rate Commission knocked off 1 percent so that the price cap was 2 percent, rate increases for all mail would be somewhere between 0 and 2 percent.

Under the Postal Service's proposal, again 3 percent inflation but no adjustment factor, it would have you set rates at anywhere between 2 points below the cap, which in its case is 3 percent, or 1.5 percent above the cap. So, under the Postal Service amendments, the rate increase, in the same situation with the same inflation,

could range for advertising mail or periodicals, what have you, between 1 percent and 4.5 percent.

I would submit that if one of the basic premises of the bill is to tighten up, then we don't want to have a range of price increases from plus 1 to plus 4.5. We want to have a range of price increases between 0 and 2. It's better for the mailer, and it's better for the economy as a whole.

Mr. FATTAH. The interaction, as you see it, and H.R. 22, as proposed, that would rearrange to some degree the third principle you talk about in your comments, this competition, notion of a fair playing field. It's hard, as I grapple with this.

The Postal Service is more than just a competitor to these other players in the market. It has these other burdens, other responsibilities, and other restrictions on it. And I'm interested in how you see, assuming H.R. 22 is passed without amendment, without any of the amendments that have been offered by the Postal Service, do you think that would create a fair playing field?

Mr. GLEIMAN. I'm sorry, I couldn't hear you?

Mr. FATTAH. Do you see H.R. 22, as it exists in its present form, creating a fair playing field, in terms of competition?

Mr. GLEIMAN. By and large, yes. We've offered a list of what we think are relatively modest amendments; proposals that I think would sharpen up the bill. But by and large, yes. When I say that, let me just say that I have some heartburn about the private law corporation. But if you are dealing with how the rates are going to be set, boxes one and two, of the three boxes, the non-competitive and competitive, I think it's workable. I think it's doable.

Mr. FATTAH. The private law corporation issue, I understand you have some concerns about it, is an opportunity for mischief to take place?

Mr. GLEIMAN. I think that we need to explore it further. And, we had some specific suggestions there, also. For example, we think that more of an arm's length relationship has to exist if there is going to be a private law corporation. Right now the directors of the corporation are appointed by the directors of the Postal Service.

There may be, and I don't have off the top of my head another way of getting those folks in place, but perhaps there is another way that would insulate them somewhat from dealings with the Postal Service, make it arms length. Also we're concerned about postal employees moving over to get higher salaries in the private law corporation.

Mr. FATTAH. I know this is a pet peeve of yours, so I don't want to get too mired down in this yet. But let us just go back to this issue of competition for a minute. Is it your view that the public's interest is served by this fairer competition that would be an outcome of H.R. 22? I'm differentiating the mailers and the other stakeholders from the public in general.

Mr. GLEIMAN. I think all of you, especially the chairman, have worked very hard at this and if you haven't leveled the playing field, you've come darn close to it. I'm not sure, how much closer you can come. In that sense, I think, yes, the public would generally be served. We have some concerns, again, about the burden shifting and the like, but I think that they can be dealt with in a reasonable manner with modest amendments.

Mr. FATTAH. I'm going to yield back.

Mr. MCHUGH. Well, I thank the gentleman for his questions. Again, I would invite any of your fellow commissioners——

Mr. GLEIMAN. I'll lean back and push the mic away.

Mr. MCHUGH. I'm not trying to move you off stage, Mr. Chairman, but I just have some very knowledgeable people here. Commissioner Omas.

Mr. OMAS. Mr. Chairman, I don't know that I have a whole lot to add. I do agree with the chairman on many of the issues. But I, too, share his concerns about the management of the private law corporation, how do you separate the Postal Board of Governors and the management structure of the governing body of the private law corporation? That is probably my biggest concern.

I think the bill as drafted is fine and you should be commended. H.R. 22 is a good bill and I think it's a workable bill. Mr. Chairman are to be commended on how you've managed to get everybody to the table. I thank you for this opportunity.

Mr. MCHUGH. Thank you, George. Well, and as I said in my opening remarks to the chairman, and the chairman's comments, I understand, are the collective thoughts and works of the entire Commission, there was a very substantial amount of work and thought and analysis that went into that and I do deeply appreciate it. And there are areas that we want to explore further, as I indicated to you, particularly where you have made, as you indicated to the ranking member, some suggestions for changes. We want to pursue those.

I will go back to my comment about the willingness that I have to re-examine the issue of contribution from the private law corporation to the Postal Service to the non-competitive, and what might be able to be constructed, if anything, to make that more clear than it currently is. I do not discount your concerns. More than that, I understand them and share them and if we can develop an approach, I would support that.

So as with past practice and as I indicated to the Postmaster General we will have some written questions. In the past you have been very gracious in responding to them and we'd appreciate that in the future. But thank you all for your good and hard work, and we're looking forward to working with you. We appreciate it.

Mr. GLEIMAN. Thank you for the opportunity and we look forward to working with you, too.

Mr. MCHUGH. Thank you, Mr. Chairman.

[Additional questions submitted to Mr. Gleiman follow:]

QUESTIONS SUBMITTED TO
EDWARD J. GLEIMAN, CHAIRMAN
POSTAL RATE COMMISSION
IN FOLLOW-UP TO THE HEARING ON H.R. 22

1. *Your testimony contained the following proposed and suggested changes to H.R. 22. Please provide suggested statutory language for our review.*

(a) *Authority for the Postal Service to file realignment case. (at 15)*

Amend § 3721 [page 13, line 17] by adding new § 3721(f) after § 3721(e), as follows:

“(f) AUTHORITY TO RECALIBRATE BASELINE RATES.—Beginning 48 months after the date upon which baseline rates take effect under paragraph (2) of subsection (e), the Postal Service is authorized to submit a request under section 3622 for a recommended decision by the Postal Regulatory Commission to recalibrate all baseline rates. Such recommended decision shall be limited to adjusting rates for all products in the noncompetitive category of mail to reflect changes in institutional cost burden by subclass, variance of worksharing discounts from cost savings, or other deviation from sound economic principles underlying the baseline rates. Any request under this subsection shall utilize then-current costs, volumes, and revenues and shall not, as nearly as practicable, result in any net increase or decrease in overall revenues for mail services.”

- (b) *Prohibition on Postal Service Board of Directors from being involved in selection of the Private Law Corporation Board of Directors. (at 27)*

Amend § 2012 [page 90, line 18] by striking from "its board" through the end of the sentence and replace it with the following:

"the Board of Directors of the Corporation shall consist of eleven members selected in accordance with the articles and bylaws of the Corporation, as follows:

- (1) five individuals appointed by the President;
- (2) three individuals designated by the Secretary of the Treasury;
- and
- (3) three individuals selected by the aforementioned members.

All individuals are to be appointed or selected solely on the basis of their technical and professional qualifications, and none of the individuals shall have been employed by the Postal Service in the preceding five years."

- (c) *A prohibition on Postal Service management employees from transferring to jobs in the Private Law Corporation and a restriction on the Postal Service from hiring Private Law Corporation employees to be postal managers. (at 27)*

Amend § 2012(d) [page 91, line 2] by adding the following at the end of § 2012(d):

"No officer or employee of the Postal Service who becomes an officer or employee of the Corporation may return to employment with, or be hired as a consultant or contractor to, the Postal Service sooner than three years following the termination of his or her employment with the Corporation. This restriction shall not apply in the event that the Corporation ceases to exist. In all events, no more than 50% of management positions in the Corporation may be filled by individuals who had been employed by the Postal Service in the preceding five years."

* * * *

- (d) *A prohibition on the Private Law Corporation from providing products totally unrelated to postal services (at 26) and de facto monopoly postal products (such as periodicals). (at 28)*

(1) Amend § 2012(a) [page 89, line 12] by changing "(a)" to "(a)(1)" and then inserting the following:

"(a)(2) The Corporation is created for the following purposes:

- (i) to operate as a business enterprise on a profitable and efficient basis;
- (ii) to maximize the long-term value of the Corporation to the United States Postal Service;
- (iii) to develop and provide competitive postal products and services, or products or services relating to competitive postal products;

- (iv) to conduct research and development as required to meet business objectives for the purposes of identifying, evaluating, improving, and testing methods of providing competitive postal products and services or substitutes for competitive postal products and services; and
- (v) to take all other lawful actions in furtherance of these purposes."

(2) Amend § 2012(e) [page 91, line 3] by inserting "To the extent consistent with the provisions of this section," before "The Corporation" and change "The" to "the."

(3) Strike § 2012(e)(1) [page 91, lines 7-9] and replace it with the following:

"(1) to offer any competitive postal product or service related to competitive postal products, including products or services that may be substituted for competitive postal products, but the Corporation may not offer noncompetitive postal products or nonpostal products;"

(4) Amend § 2012(f) [page 91, line 19] by inserting "the Postal Regulatory Commission determines after a hearing" before "represent."

- (e) *A requirement that the Private Law Corporation pay a significant portion of its earnings (as dividends) to the Postal Service. (at 29)*

Amend § 2012(c) [page 90, line 9] by changing "(c)" to "(c)(1)" and adding the following:

"(c)(2) After the first three full years of operation, the Corporation shall be obligated to pay dividends on its capital stock in such amounts and at such times as shall be determined annually by the Secretary of the Treasury. One-half of such dividends shall be transferred from the Postal Service Competitive Products Fund to the Postal Service Fund and shall be used by the Postal Service to reduce the rates, or ameliorate increases in the rates, applicable to noncompetitive postal products. Once the Corporation is obligated to pay dividends, the Corporation may not pay bonuses or make other extraordinary payments to officers or employees unless dividends as determined herein are paid."

* * * *

- (f) *A designation that a portion of profits not be susceptible to distribution as bonuses. (at 34)*

Amend § 3773(d) [page 62, line 24] by changing "100" to "50".

Amend § 3773(e)(1) [page 63, line 12] by changing "(B) the remainder (or any portion)" to read as follows: "(B) up to one half of the remainder"

* * * *

- (g) *Make rejections of Commission recommended decisions subject to judicial review. (at 37)*

Add to § 202 (e) a new (B) [page 70, line 24] as follows, and renumber (B) and (C), as (C) and (D):

(B) by inserting before "or modify" the following: "reject,"

* * * *

- (h) *Language that requires worksharing discounts to reflect cost savings. (at 6)*

Amend § 3732(b) [page 18, line 16] by adding after "year." the following:

"In instances when worksharing discounts are available, those discounts shall equal as nearly as practicable the costs avoided by the Postal Service as a result of the action for which the discount is awarded."

* * * *

- (i) *Clarifying amendments concerning negotiated service agreements to: (1) state negotiated service agreements are not a substitute for mail classification changes; (2) state NSA must produce net financial benefits to the Postal Service and mailers generally. (at 12-13)*

(1) Amend § 3641(a) [page 72, line 19] by adding after "under this section" the following: "shall be appropriate to recognize unusual situations and shall not be entered in to as a substitute for requesting a generally applicable classification change under section 3623. A negotiated service agreement"

(2) Amend § 3641(c)(1) [page 75, line 3] by renumbering (C) as (D), and inserting the following before (D):

"(C) will not result in net financial benefit to both the Postal Service and mailers generally; or"

- (j) *The Commission be instructed to report shifts in institutional cost burdens, and whether worksharing discounts reflect cost saving. (at 15)*

Amend § 3771(b) [page 55, line 20] by striking "an estimate" after "such report," and by adding after "such report," the following: "the institutional cost burden of products and services offered by the Postal Service, and the shifts in institutional cost burdens since the previous report; analysis of the extent each available worksharing discount reflects costs savings; and, estimates"

[Please note, if the amendment suggested in response to question (h) (above) is added, the interaction of revised § 3732 and existing § 3773(c)(1) will result in a written determination of whether worksharing cost discounts reflect cost savings, and the separate requirement for an "analysis of the extent each available worksharing discount reflects costs savings;" may be unnecessary.]

- (k) *Bonuses should not be tied to only previous year's profits. Suggestion to use a moving or weighted average. (at 35)*

Amend § 3773(d) [page 62, line 24] by replacing "up to 100 percent of the profits attributable to such year (if any)" with the phrase "an amount", and [page 63, line 2] replacing "subsection (f)." with the following: "subsection (f) equal to 100 percent of a weighted moving average consisting of 40 percent of profits in the most recent year, 30 percent of profits in the year before that; 20 percent of profits in the year before that; and 10 percent of profits in the year before that."

Amend § 3773(e)(1)(A) [page 63, line 9] by replacing "up to 100 percent of the profits attributable to such year (if any)" with the following: "of a weighted moving average consisting of 40 percent of profits in the most recent year, 30 percent of profits in the year before that; 20 percent of profits in the year before that; and 10 percent of profits in the year before that."

* * * *

(f) *Bonuses should explicitly reflect changes in productivity. (at 35)*

Amend § 3772 [page 58, line 20] by renumbering (d) through (g) as (e) through (h), and adding a new (d) before (e) to read as follows:

"(d) TOTAL FACTOR PRODUCTIVITY.—

"(1) The Postal Service shall, no later than 90 days after the end of each year, prepare and submit to the Postal Regulatory Commission a report (together with such nonpublic annex thereto as the Commission may require under subsection (g)) on its total factor productivity during such year.

"(2) The Postal Regulatory Commission shall audit this information, and not later than 90 days after receiving it shall issue a written report on the change in Postal Service total factor productivity during such year, and an analysis of possible causes for that change.

Amend § 3773(f)(2) [page 64, line 4] by replacing "(B) . . ." with the following:

"(B) bonuses are to reflect changes in the Total Factor Productivity of the Postal Service, and are not exceed an amount equal to—

"(i) a weighted moving average of the annual percentage change in Total Factor Productivity reported by the Postal Regulatory Commission consisting of 40 percent of the change in the most recent year, 30 percent of the change in the year before that; 20 percent of the change in the year before that; and 10 percent of the change in the year before that, applied to

"(ii) total accrued costs in the most recent year.

[Conforming amendments: In § 3772(a) [page 57, line 2] and § 3772(b) [page 57, line 21] change "subsection (e)" to read "subsection (f)"; and in § 3772(g) (redesignated from § 3772(f)) [page 60, line 15] change "subsection (d)" to read "subsection (e)".]

(m) *Allow appeals when emergency suspensions of post offices remain in effect for more than six months. (at 37)*

Amend § 404(b) by renumbering (5) to (6) and adding a new (5) before (6) to read as follows:

"(5) The suspension of service at a post office due to exigent circumstances does not constitute a closing or consolidation unless

service has been suspended for more than six months and the Postal Service has not initiated action under (b)(1) of this section, or provided persons served by the office with a written statement of the steps taken to resume service along with a determination of when service will resume."

Amend § 404(b)(6) by adding after "close or consolidate any post office" and before "may be appealed", the following: "or to fail to resume within six months, service that was suspended due to exigent circumstances," and by replacing "under paragraph (3)." with the clause "under paragraph (3) or (4)."

2. (a) *What is the connection and/or similarity between price caps in the telecommunications industry and price caps in the postal service?*

The Postal Service continues to operate a statutory monopoly and exercise market dominance in most of its product lines. The telecommunications industry today continues to be affected by its growth as a monopoly through which the Bell System exercised market dominance in most of its product lines. Today there is strong competition in aspects of the telecommunications industry, however the component parts of the Bell System still exercise market dominance in important areas.

Price caps were applied to dominant firms in the telecommunications industry in part to allow those firms to exercise more pricing flexibility and to ease regulatory burdens. Some observers believe that the Postal Service also would benefit from these changes.

I must point out however, that postal and telecommunications are not a perfect match. In particular, telecommunications firms are privately owned, which makes them far more subject to a strong profit motive. A price cap allows the firm to retain all profits earned while pricing below the cap, and the incentive to impose strict efficiencies in order to earn "excess" profits is far more applicable to a private firm than to a government monopoly.

Further, the telecommunications industry is characterized by declining real costs and it is not hourly-labor intensive. The productivity offset factor in telecommunications also can be satisfied through its relatively frequent technology changes. In contrast, the Postal Service has not been generally characterized as having declining costs or rapid changes in technology. Finally, worksharing is not as common in telecommunications as it is in postal, where more than 65 percent of current volume pays rates discounted to reflect worksharing.

(b) A recent AP poll stated that three-fourths of Americans believe the postal service is doing an excellent or good job. Will the general public, the "Aunt Minnies" of the country support H.R. 22? What's in it for them?

The AP poll went on to say that the cost of stamps is too much. Any idea how much Aunt Minnie will pay for postage under H.R. 22?

Theoretically, as currently written H.R.22 should assure that First-Class postage rates will rise less quickly than inflation. Since Postal Reorganization, First-Class rate increases generally have closely tracked inflation. Maintaining below-inflation increases in postage rates should help retain or improve the positive image of the Postal Service currently held by most Americans. However H.R. 22 also will allow rates to change each year to reflect inflation. The general public finds rate changes inconvenient, and more frequent increases may foster negative impressions of the Postal Service.

(c) If we were to enact H.R. 22 today, as currently written, how would postal jobs, services, and postage rates be impacted?

These are clearly the central issues facing Congress as it considers whether to enact H.R. 22. Honestly, I do not think I can reliably predict the eventual impact on jobs, services, and rates of legislation as sweeping and complex as H.R. 22. I do know that there will be disruption and uncertainty during implementation. In particular, there are a number of areas that I pointed to in my February 11, 1999 testimony before this subcommittee, that in my opinion are subject to multiple, conflicting interpretations. I believe that if H.R. 22 were enacted as currently written, many if not all of these problem areas would almost certainly become the subject of litigation, and that the outcome of such litigation would have a major impact on how postal reform effected jobs, services and rates.

One of the purposes of H.R. 22 is to hold down rate increases through price caps. The expectation is that the Service will have to restrain costs in order to break even if price caps limit the amount it can raise rates. Most postal costs (between 75 and 80 percent) are labor related, so restraining costs will probably take the form of smaller wage increases or fewer employees. Either of these impact jobs, and could well impact service. Service was affected negatively earlier this decade when the Postal Service attempted to restrain costs by reducing its employee complement.

(d) How does the price cap provision contained in H.R. 22 impact labor relations and collective bargaining? How does the Private Law Corporation impact collective bargaining?

The price cap and Private Law Corporation provisions of H.R. 22 would alter the landscape on which collective bargaining currently takes place, but I can not offer a reliable prediction of how the changes would play out. If the Private Law Corporation was utilized as a contracting arm to farm out multiple postal operations to non-postal firms, this would be very likely to reduce any existing cooperative atmosphere in the collective bargaining between postal employee organizations and management. On the other hand, if it successfully spawned new postal related businesses that generated additional mail volumes, this could make collective bargaining easier.

Similarly, the price cap provision is intended to restrain rate increases and foster a more efficient Postal Service. While this might mean that management would be inclined to bargain more aggressively, one must bear in mind that the opportunity for employees to earn substantial bonuses is an integral part of the price cap calculus of H.R. 22, and that the receipt of annual performance-based bonuses might foster more cooperative collective bargaining.

Questions Submitted to
The Honorable Edward J. Gleiman
April 15, 1999

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(e) Last month the GAO issued a report describing the major performance and management challenges that need to be addressed if the postal service is to sustain performance and remain competitive into the 21st century.

In what ways can the postal service further reduce costs and what savings can be realized from the ways you have mentioned?

I have no further comment in this regard.

(f) Can we in the Congress provide the postal service greater flexibility to set rates, provide volume discounts and offer new products quickly, without the establishment of a new price cap rate setting mechanism and the creation of a Private Law Corporation? If not, why not? If so, how?

The price-cap mechanism is intended to be a way to afford the public protection against unreasonable or excessive rate increases that postal management might be tempted to impose on captive customers if it had broader flexibility to change rates. Similarly, the Private Law Corporation is intended to be a means of limiting the extent to which Postal Service resources, especially those derived from the monopoly, are used to underwrite new ventures outside of the Service's core business area. Clearly, these major departures from existing law are not the only avenues available to provide the Service with pricing flexibility, volume discount authority and/or the ability to offer new products more quickly. As a matter of fact, conceptually the Private Law Corporation has little if any relationship to pricing flexibility. Moreover, it would only impact volume discounts and the offering of new products if the legislation anticipates this new private entity being involved in providing services and products that traditionally have been within the domain of the Postal Service.

On the matter of offering new products quickly, I would note that the Commission recently adopted rules providing for consideration of proposed Postal Service experiments and other innovations on an expedited schedule — in 90 to 120 days — and any further reduction in the PRC's turnaround time for Postal Service requests could jeopardize the opportunities for affected parties and the public to participate meaningfully. Likewise, changes involving greater flexibility in pricing of, or providing volume discounts for, postal services must be examined in the context of whether the Nation and the public would be well served by changes that might remove the protections current law provides the

mailing public against unfair, inequitable, and unwise actions by postal
management.

(g) The postal service is grappling with labor-management issues, the challenges of containing costs, the need to better protect revenues, the need to implement reliable indicators of postal performance and risks from Y2K computer problems. Can we expect the postal service to address all these very serious matters and be subject to the type of postal reform envisioned in H.R. 22?

Implementing the significant changes that would be brought about by H.R. 22 would certainly require a substantial commitment of time and energy by every level of postal management, the PRC, and the mailing community. I am certain that the Service would attempt to continue to address the important labor and operations issues that you have identified while that process was underway, but the passage of sweeping postal reform legislation would clearly put many new and difficult issues on management's plate.

(h) Should congress provide more of a public oversight role to assist the postal [service] in better controlling costs and improve productivity?

Continuing public oversight by Congress has played an important role in assuring that the Postal Service is responsive to the needs and concerns of the American public. Additional oversight focus on specific cost and productivity issues should certainly make a positive contribution.

(f) Do we need to pass H.R. 22 to effect postal reform or can we work within the existing statute to bring about changes and improvements in postal structure and operations. If so, be more specific.

I believe the current postal law has served the nation well, and that it is sufficiently flexible to accommodate significant postal reform. The important first step is to identify what are the goals of any prospective reform. Only when goals are clearly delineated is it possible to specifically describe potential changes that will accomplish the desired reform. For instance, if the reform is intended to restrain future rate increases, a price cap mechanism may be a reasonable way to proceed. However that same goal also may be achieved without many of the changes currently contemplated by H.R.22. It should be possible to restrain increases under the current law by implementing a policy of tying bonuses for postal employees to improvements in total factor productivity, a policy which would not require any legislative action. Recent press reports suggest that another way to restrain increases would be to capture a higher proportion of the potential savings available as a result of worksharing discounts.

I must add that H.R. 22 also includes provisions designed to achieve other important goals that may only be achieved through legislation. For example, the goal of providing mailers with more public, effective means for having complaints heard and resolved would seem to require amendments to the complaint section [§ 3662] of Title 39.

(j) Currently, postal workers participate in the Federal Employees' Health Benefits Program (FEHBP) and in the Federal Civil Service Retirement program. What happens to postal workers' health and retirement benefits under the Private Law Corporation?

Workers who remain in the employ of the Postal Service would continue to participate in these programs. As for employees of the Private Law Corporation, it is not clear that they would receive these benefits.

Mr. MCHUGH. The next panel is comprised of the management associations. As we're in the process of changing the name placards, we are pleased to welcome today the president of the National Association of Postmasters of the United States, Ted Carrico; the president of the National League of Postmasters of the United States, Joe Cinadr; and the president of the National Association of Postal Supervisors, Vince Palladino. Welcome, gentleman.

We have a substitute in the line up. Now playing, Vince Palladino will be——

Mr. KEATING. My name is Ted Keating. I'm the executive vice president for the National Association of Postal Supervisors. Mr. Palladino was called home to New York last night. His father is critically ill. He expresses his regrets at not being here this morning.

Mr. MCHUGH. Well, that's very, very sad and troubling. Please express our best wishes to him, and particularly his father, our concern that he have a full and speedy recovery. But we do welcome you and thank you for being here and for sitting in in representation of the National Association of Postal Supervisors.

I'm sorry I allowed you to be seated before we administered the oath, so if you will bear with me, please rise.

[Witnesses sworn.]

Mr. MCHUGH. The record will show that all three witnesses responded in the affirmative to the oath. With that we will, as in the past two panels, say that all of your prepared testimony will be submitted in its entirety to the record. We would ask as we yield to you if you would summarize your comments and make those kinds of observations as you see fit.

So, again, welcome. And we'll proceed in the order in which you are represented here today, beginning with President Carrico of the National Association of Postmasters. Welcome. Good to see you again.

STATEMENTS OF TED CARRICO, PRESIDENT, NATIONAL ASSOCIATION OF POSTMASTERS OF THE UNITED STATES; JOE CINADR, PRESIDENT, NATIONAL LEAGUE OF POSTMASTERS OF THE UNITED STATES; AND TED KEATING, VICE PRESIDENT, NATIONAL ASSOCIATION OF POSTAL SUPERVISORS

Mr. CARRICO. Thank you Mr. Chairman, members of the subcommittee. I am Ted Carrico, the Postmaster of Palisade, CO. I also have the honor of serving as the national president for the National Association of Postmasters. We represent more than 45,000 active and retired postmasters who ultimately are responsible for the quality of mail service provided to cities large and small, as well as to those areas which have no definable municipality.

Palisade, CO, is located in a rural area of western Colorado, much like the hamlet in upstate New York that you call home. As you know, we have some different needs in rural America than the rest of the community. H.R. 22, I think, addresses those needs very well.

Postmasters want to ensure that delivery is provided to each and every one of our customers every day, everywhere, and I think that your bill does that. For a long time, though, detractors have alleged that the Postal Service is a lumbering dinosaur whose time for ex-

inction has long passed, and that the private sector can do things a lot better than the Postal Service.

I've not seen that in rural America. Rural America depends upon, I guess it's what I would call the subsidy that is provided by the larger markets, the big cities in America. I've heard many discussions about all the baskets and stuff. And, you know, postmasters aren't concerned about baskets, we're concerned about delivering the mail. We're concerned about fair play.

And we realize that mail can be delivered in the larger cities a lot cheaper than it can be delivered in the small towns. We rely on new ideas to build upon that revenue, the growth coming in, new products, new services. And I think the Postal Service is doing an outstanding job. If you look at the recent polls, and I think all politicians look at polls, the AP poll found that 75 percent of Americans believe that the Postal Service is doing an excellent or a good job. Last year a Pew Research Survey concluded that the Postal Service enjoys a 90 percent approval rating. And in the most recent Price Waterhouse survey, it was determined that 93 percent of over-night First Class Mail is being delivered on time.

Americans demand a strong Postal Service that will provide essential value to everyone. Postmasters know your goal is to strengthen the agency so it can support uniform service to every community in the Nation, thus enabling the Postal Service to expand its revenue and to support the infrastructure making universal service possible.

Let me assure you postmasters, side by side with the entire Postal management team and the loyal hardworking craft employees, will continue to work to see that these new revolutionary products and services are provided to the American public.

I have a concern that our competitors would like to do some cherry picking, and that's where we have to protect the American people. There has been many times in my career that postmasters or the postmaster organization doesn't always agree with the Postal Service.

We take public service real seriously. And there is probably no other group that's engaged with communities across this country more than postmasters. Many times the Postal Service will make a proposal that will find us on the other side of the table, whether it be the box rent issue that we had 2 or 3 years, or the closing of small post offices.

This bill must take care of rural America and intercities but it must also strengthen the Postal Service so we can do this. I think your job and my job first and foremost must be to take care of all Americans. We have a service that's set in place. We do not have to redefine that whole service but we have to fine tune it to make sure that that service is there for our kids and our grandkids. Those are the concerns that I have. I've summarized it pretty briefly.

It's a very competitive industry out there. We all know that e-commerce, foreign posts, many different things are going to affect service in the future years, but I think we're taking a step in the right direction. And I just want to let you know that postmasters are willing to work with you or anyone else who is willing to enhance the service that we have and protect the interests of the American people. Thank you, Mr. Chairman.

[The prepared statement of Mr. Carrico follows:]



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Testimony of Ted Carrico

National President

National Association of Postmasters
of the United States

Before the

House Subcommittee on the Postal
Service

February 11, 1999

Mr. Chairman, members of the Subcommittee, I am Ted Carrico, postmaster of Palisade, Colorado. I also have the honor of serving as national president of the National Association of Postmasters of the United States. NAPUS represents 45,000 active and retired postmasters who are ultimately responsible for the quality of mail service provided to cities, large and small, as well as areas for which there is no definable municipality.

Mr. Chairman, Palisade is a rural community located in western Colorado. It is a community much like the hamlet in upstate New York you call home. The residents and businesses in both places rely on the Postal Service to provide a point of access to the rest of the country and to the entire world. Many inner-city neighborhoods also have come to depend on the Postal Service as their conduit to the country. Only the Postal Service can offer nondiscriminatory access to the communications and parcel delivery marketplace. This is the type of uniform service Americans have come to expect from the most efficient communications enterprise in the entire world.

As many postal critics pay homage to the deregulation and commercialization frenzy of foreign posts, we must pay attention to this country's recent experiences with deregulation. We know, for example, this Subcommittee is keenly sensitive to the type of market changes that devastated many communities as the result of airline deregulation. Air service to these areas were either eliminated or became prohibitively expensive due to efforts to reform the airline industry. We cannot permit communications and parcel blackouts to rural communities or inner-city neighborhoods -- locales where mail volume does not necessarily justify full service postal operations.

A few interests have concluded that the Postal Service should confine its operations to the distribution of single-piece hard-copy letter mail. I am here to say that this type of restriction would lead to the demise of universal, uniform postal services. Innovation and the revenue that such innovations yield are what safeguard universal services.

For too long, our detractors have alleged that the Postal Service is a lumbering dinosaur whose time for extinction has long passed. If this were the case, then they would not be so threatened by the strides that the Postal service has taken to make more postal products available to so many people at a reasonable price.

Innovation had, in fact, enhanced your constituents' satisfaction with the Postal Service. The American public has lauded the U.S. Postal Service with record approval ratings and our on-time delivery scores are at an all-time high. A recent AP Poll found 75 percent of Americans believe the Postal Service is doing an "excellent" or "good" job. Last spring's Pew Research Center survey concluded that the Postal Service enjoys a 90 percent approval rating. And the most recent Price Waterhouse survey concluded 93 percent of overnight First Class mail is being delivered on time.

The American public demands a strong Postal Service that will continue to provide an essential and valued public service. Postmasters know your goal is to strengthen the agency so it can

support uniform service to every community in the nation. Thus, we must enable the Postal Service to expand its revenue to support the infrastructure making universal service possible. Let me assure you that Postmasters, side-by-side with the entire Postal Management Team and loyal, hardworking craft employees, will work to guarantee that the Postal Service will continue to offer revolutionary services and products to the American public.

Postal detractors would like nothing more than to pick off popular postal products and services to expand their own market share. Or, more likely, they would force the Postal Service out of competitive ventures. In this way, they could have the unfettered ability to raise their own prices without the market interference of affordable U.S. Postal Service products and services. These interests who champion the free market seek to exclude an efficient public service enterprise from any type of activity that can compete effectively against the for-profit sector. This is wrong-headed, and would condemn millions of Americans and businesses throughout the country to overpriced, discriminatory communication and parcel services.

As this Subcommittee has recognized from the very beginning, the Postal Service is accountable to each and every citizen and business in this nation. The for-profit entrants in the postal market are accountable to only a handful of boards of directors and shareholders. While the Postal Service uses its revenue to improve mail services and hold down postage rates for all Americans, the for-profit participants use their profit to pay dividends to the board and the stock owners. Only the Postal Service has a sacred obligation to provide universal service to urban, suburban, and rural America. We deliver every day, to everyone, everywhere. Postmasters appreciate the Subcommittee's recognition of this unassailable fact.

Mr. Chairman, as you know, NAPUS has collaborated with you as you constructed, and then reconstructed the Postal Modernization Act. Probably more than any of the other participants in this exercise, Postmasters understand the need for the Postal Service to modernize. Postmasters oversee all facets of postal operations, including delivery, processing, and retail services. We know innovation is what will allow the Postal Service to continue to be a dynamic participant in the communications and parcel delivery area as we cross into the new millennium. H.R. 22 provides the framework, and much of the flesh and bones to achieve that goal.

We understand the underlying tenet of H.R. 22 is to make it possible for the Postal Service to continue its core mission of providing universal service. The bill also recognizes the necessity of enabling the Postal Service to bring revolutionary products and services to its customers. In this way, the legislation balances the revenue needs of the Postal Service with its prime directive. In sum, H.R. 22 empowers the Postal Service to remain a vibrant participant in the communications market. At this point, I would like to highlight a number of our observations about H.R. 22.

Postmasters strongly agree with you that greater price and operational flexibility will permit the Postal Service to be more responsive to the changing needs of our expanding customer base. We agree with you that neither the Postal Service nor its customers should continue to be burdened by the protracted and overly cumbersome rate-setting process. We will continue to work with

you to flesh out the specifics of the noncompetitive category market baskets, the rate-setting issues, and the appropriate formula for determining price changes.

Postmasters support the provision added by Representative Gilman that would preclude the Postal Regulatory Commission from penalizing the Postal Service for providing postal employees with fair compensation.

Having said that, Postmasters remain concerned about the direct appropriation for the Postal Regulatory Commission. We believe that such a relationship between the Congress and the PRC could resurrect the type of congressional micro management of the Postal Service that the original Postal Reorganization Act sought to eliminate. In addition, it would provide a new avenue for our for-profit detractors to financially cripple the Postal Service.

Postmasters applaud your efforts to permit the Postal Service to execute negotiated service agreements with its customers. However, NAPUS would like to work with you to provide the Postal Service with more latitude in negotiating such agreements.

Postmasters also appreciate your recognition that communities should have greater involvement in decisions to close post offices. A post office is the anchor of many communities throughout the country. As a result, the Postal Service should not hide behind "emergency suspensions" to terminate full-service postal operations in many communities. It's ironic that the Postal Service was more concerned about the public's view of which graphic version of Elvis Presley would grace that stamp than it is about a community's view about the continued presence of its post office.

Postmasters continue to be concerned about contraction of the double-postage rule. We believe that revenue earned through "Priority Mail," a highly popular postal product, will be siphoned off by the for-profit sector. This would leave the Postal Service with Priority Mail to be delivered to high-cost, low-volume areas, raising the unit price for product. In addition, revenue attributable to this product will be lost by the Postal Service, reducing financial support for universal service.

Lastly, Postmasters respectfully request you consider the suggestions made by the Postal Service to modify your legislation. We believe that many of the agency's proposed amendments would help improve on the trail-blazing work that you have completed.

Mr. Chairman, we recognize that postal reorganization, reform, modernization, or transformation – call it whatever term is most appropriate – has been an extremely challenging venture. I know that each and every postmaster appreciates the long hours you, your fellow Subcommittee members and your staff have put into this effort. The road that this Subcommittee has traveled has been a long and difficult one. As you recognize, there is still a long way to go, and it won't get any easier. Postmasters look forward to continuing to assist you and your staff members in the journey.

Togther, we will chart a course to strengthen the Postal Service.

Thank you.

Mr. McHUGH. Thank you, President Carrico for your comments and also for your cooperation. Next, President Cinadr, National League of Postmasters of the United States. Welcome, sir.

Mr. CINADR. Thank you. It's a pleasure to be back with you. As you stated, I am Joe Cinadr. I am the postmaster of Mansfield, OH, and I have been serving the National League of Postmasters for the last 5 years as vice president, executive vice president, and now as national president.

I do appear before this committee today on behalf of the Nation's postmasters, retired postmasters and associate members of the League of Postmasters. And I do thank you, Mr. Chairman, for allowing my entire written testimony to become part of the record. As you requested I will simply highlight what I consider to be the most important parts of that testimony.

First, representative postmasters from our 50 States, commonwealths, and territories will be here in Washington, DC, the first week of March to personally express their opinions of H.R. 22 and many pieces of legislation to their own Congressmen and Senators.

Our primary focus is for the U.S. Postal Service to remain the best Postal Service in the world, and for postmasters to maintain their leadership role. The results of the legislation being considered must allow us to continue to provide all Americans with universal service at reasonable prices. We do, as Mr. Henderson stated earlier, need the authority to offer reasonable volume discounts, again, for us to remain competitive and engage in what are commonly accepted as good business practices.

Almost everyone, some more grudgingly than others know how good we are. As Ted mentioned, the Pew Research Center survey and the Associated Press survey this past month proved that. We do what no one else does or even wants to do, and that is to provide excellent mail service to towns and hamlets like Pierrepont Manor, NY; Pineland, SC; Wayland, OH; Suplee, PA; Bethel, NY; Lee Center, IL; and many, many others too numerous to mention.

I am reminded, as I sit here, of Senator Ted Stevens' remarks as I review with concern that this bill could become a vehicle for undercutting the basic principles of the Postal Reorganization Act of 1970. What he said was, "Our Postal Service is a national treasure. A vital organization made up of outstanding people." We in the League certainly value his judgment and thank him for his continued support.

We had serious problems in the 1960's and needed corrective and farsighted legislation. What I see now is an attempt by our competitors to regulate or re-regulate the most successful Postal Service in the world. I ask why we need organizations and or individuals with little or no postal experience or knowledge making decisions that will impact our futures, our pay, our benefits, and most importantly universal services?

The issues are not taxes, tickets and tags. The real issues are prices and universal service. I look forward to our postmaster visits to the Hill on March 2nd. Postmasters are valuable contributing members of our communities and our country, and they serve much more than just collecting, processing and delivering the mail.

I do pledge to work with this committee as long as this bill, as reported out, continues to allow postmasters to provide excellent

mail service and keep the customer first. I thank you for allowing me to testify. I will entertain your questions.

Mr. MCHUGH. Thank you, President Cinadr.

[The prepared statement of Mr. Cinadr follows:]

Statement by

Joseph W. Cinadr

President

National League of Postmasters of the United States

Before the

House Subcommittee on the Postal Service

Washington, D.C.

February 11, 1999

STATEMENT
OF JOSEPH W. CINADR
PRESIDENT
NATIONAL LEAGUE OF POSTMASTERS
ON HOUSE SUBCOMMITTEE ON THE POSTAL SERVICE
HR 22 - THE POSTAL MODERNIZATION ACT OF 1999
FEBRUARY 11, 1999

My name is Joe Cinadr and I have been serving The National League of Postmasters for the past five years as Vice President, Executive Vice President, and now as President. I have also served as Adverse Action Counselor and Vice President for the State Branch of Ohio for the League. I appear before this committee today on behalf of our nation's postmasters, retired postmasters and associate members of the League. I wish to thank you, Mr. Chairman, for allowing me the opportunity to testify before your committee. I am very aware of the time you have devoted to these postal issues and the resources and studies involved to produce this bill -- HR 22.

Postmasters are very interested in your legislation. In fact, they will be here in our nation's capitol visiting the Hill the first week of March to personally express their opinions on this subject and many others to their own congressmen and senators.

I am aware that you and your staff are continuing to negotiate with the U.S. Postal Service leaders and others to arrive at a final legislative consortium. I anticipate we will have concrete suggestions once that process is complete sometime after the next day of hearings on March 3, 1999.

Our primary focus is for the Postal Service to remain the best postal service in the world and for postmasters to maintain their leadership role in always striving for excellence. The result of any legislation passed on by this subcommittee should be to allow us to continue to provide all Americans superior universal service at a reasonable price.

We have asked and we ask again that your bill allow the Postal Service the financial flexibility to continue our success as demonstrated over the past four years and provide our customers with rate stability. We also need the authority to offer volume discounts to be competitive and engage in commonly accepted good business practices.

I was reminded as I prepared this testimony, that almost everyone, some more grudgingly than others, knows just how good the U.S. Postal Service is. A recent Associated Press survey was very favorable to our postal service. We must continue to exist and provide service in such towns as:

Pierrepont Manor, New York
Grover, South Carolina
Fremont Center, New York
Wayland, Ohio
Suplee, Pennsylvania
Obernburg, New York,
East Lynn, Illinois

because no one else will or even wants to try.

"Our postal service is a national treasure, a vital organization made up of outstanding people". Senator Ted Stevens (R-AK) said what many of us are trying, in many different ways, to say. We are concerned that this bill could become a vehicle for undercutting the basic principles of the Postal Reorganization Act of 1970.

I believe our success has heightened the attention we are receiving -- the dollars we have made, the productivity levels, the community involvement and yes, beating our competition -- all these achievements have turned many envious eyes on us. We have served this country well for over 224 years.

The Postal Reorganization Act passed in 1970 and effective in 1971 was necessary to correct many serious problems. The results of that legislation and the dedication of many postal employees have stood the test of time. We are unexcelled as a postal service in this world. And we have been successful because we fully understand our overriding responsibility to serve the American public.

Too good, too successful, too business-like! The U.S. Postal Service is the best and postmasters are major players in that success. We ought to be imitated and rewarded, not penalized for our dedication and service.

I must question why we need more regulation, why we need others with little or no postal experience or knowledge to make decisions that will impact our futures, our pay and our benefits. We don't need to return to over-involvement of Congress in the management of the U.S. Postal Service. The League opposes attempts to involve Congress in postal rates or wage scales.

I have no personal axe to grind with the leaders of our chief competitors, but I will represent the postmasters who elected me. The issues are not taxes, tickets and tags -- they are price and service. Our customers have three requirements: 1) universal reach, 2) timely, reliable and consistent service, and 3) reasonable prices. And we deliver on each of these requirements.

I believe this bill is reregulating the wrong organization. We, the postal service and postmasters, were challenged by our customers through their congressional representatives in the late 1960's to become more business-like. Now that we are, the message appears to be we are too efficient, too cost conscious, too competitive!

As a postmaster, I believe I am a vital part of the United States Postal Service. I'm very proud to be President of the National League of Postmasters. I'm here to guarantee the future of both organizations. I look forward to our postmasters visiting the Hill on March 2nd and you hearing first hand their positions and opinions. Postmasters are contributing members of our communities and the country. We intend to be here long after some of our detractors have come and gone.

Thank you for this opportunity to express my opinions.

Mr. MCHUGH. Finally, we move to Vice President Ted Keating, who is, as we've heard, sitting in for President Vince Palladino of the National Association of Postal Supervisors. Mr. Keating, welcome.

Mr. KEATING. Good afternoon Mr. Chairman, members of the committee. My organization has appeared before this committee in the past and expressed concerns about the make up of the original version of H.R. 22, and subsequent versions. You and your committee have addressed those concerns by making changes and we would like to thank you at this time for that.

President Palladino's testimony is on the record. I'm not going to read the entire thing, but he did ask me to make a couple of comments which would be that we reserve the right, with your permission, to come back and make final comments on the final language of H.R. 22, whenever that may be.

He did ask me particularly to read his closing remarks, which is page 4 of his testimony, which is as follows.

In closing Mr. Chairman, I caution that as we focus on the details of H.R. 22, as clearly we must, we do not at the same time lose sight of what we are putting together here.

Accordingly, I must respectfully propose to you and your distinguished colleagues the question of overriding concern to me. You could call it food for thought. I'll state it as simply as I can. As we rush headlong into creating a Postal Service that walks, talks and otherwise operates like a public corporation, are we truly crafting an entity that has a genuine chance of survival?

More to the point, Mr. Chairman, what commercial enterprise in this country would remain in business long if its officers had to operate under a host of Federal statutes governing the types of products and services it could offer and at what price, and under the watchful eye of, all at the same time, a Board of Governors, our Directors, Postal Rate Regulatory Commission and Inspector General and, with all due respect, a Congressional oversight committee or two? I pray you probably know the answer to that question.

We thank you again for the opportunity again to appear before you. It's always a privilege to work with the committee and look forward to future testimony on this. Thank you very much.

Mr. MCHUGH. Thank you, Vice President Keating. And, again, please pass our best wishes on to Vince Palladino and wish his father, as I said, a speedy and full recovery.

Mr. KEATING. Thank you.

[The prepared statement of Mr. Palladino follows:]

Testimony

before the

House Subcommittee on the

Postal Service

Vincent Palladino

President

National Association

of Postal Supervisors

Feb. 11, 1999

Mr. Chairman and members of the Subcommittee, my name is Vincent Palladino. I am President of the National Association of Postal Supervisors. NAPS is privileged to represent some 37,000 active and retired postal supervisors, managers and postmasters, who, understandably, have a vested interest in helping shape a competitive, affordable and, above all perhaps, universal Postal Service of the future.

I appreciate the opportunity today to once again offer our views on H.R. 22, the "Postal Modernization Act of 1999." I believe this is my third appearance before the Subcommittee on this matter, which is so fundamentally central to our nation's continued prosperity in the commerce and communications marketplaces.

I believe you are deserving of some kind of perseverance award, Mr. Chairman, for continuing the valiant struggle to rally such diverse interests toward responsibly addressing the difficult question of how best to restructure the nation's postal system. Postal reform has, indeed, proven to be a "work in progress," and NAPS certainly is appreciative of the opportunity not only to be heard in this great debate, but to help shape the legislation before us today.

In deference to the Subcommittee's busy schedule, and perhaps to avoid repeating the main gist of the testimony of my postal management association colleagues, I will be brief.

I am pleased to note, Mr. Chairman, that most of our respectful objections to the original and subsequent versions of postal reform legislation have been addressed to our satisfaction.

We had objected during two previous hearings to the proposed makeup of an unidentified presidentially appointed Postal Management Commission that would be named to wrestle with the labor-management difficulties the Postal Service continues to face. We were especially concerned, Mr. Chairman, about the fact that, as envisioned, no member representing Postal Service management would sit on the commission.

We are pleased the revised legislation would provide for such a study to—and I quote from the legislation—"involve the labor, supervisory and managerial associations of the Postal Service in developing the design and specific objectives of the study." End quote. That said, however, NAPS is left to wonder whether such a study really is necessary, given the notable success record of the past several postal Summits in helping foster an improved labor-management environment on the workroom floor.

I believe it was at your suggestion, Mr. Chairman, that these Summits be conducted with the cooperation of representatives of the Federal Mediation and Conciliation Service. I will be the first to say the Summits got off to a shaky start. Since those initial forays into addressing this vexing problem, however, I have found that—

together—we *are* learning to put the Postal Service's labor-management relations house in order. The Summit process is working so well, in fact, that NAPS recommends an independent study by the National Academy of Public Administration, as outlined in H.R. 22, be authorized *only* if the Summit process now under way should fail.

As you will recall, Mr. Chairman, NAPS also had objected to a provision of the original bill that would have allowed the Postal Service to petition for judicial review in the U.S. Court of Appeals for the Federal Circuit of—quote—"certain decisions" of the Merit Systems Protection Board. If—quote—"certain decisions" referred to granting the Postal Service the right to defend federal court appeals of MSPB decisions against the agency in the matter of employee adverse actions, then, we stated, we were in firm opposition. We are pleased that you and fellow Subcommittee members have seen the wisdom and fairness in removing from the legislation references to Postal Service appeal of MSPB decisions against the agency. We thank you for that action.

We had strongly opposed, Mr. Chairman, provisions of the original bill that would have permitted non-Postal Service access to citizens' private mailboxes and authorized a mailbox demonstration project. We are delighted that reason, common sense and good judgment prevailed here, too, and those provisions have been removed from the legislation.

NAPS formerly opposed—and still must—the provision of H.R. 22 that would permit commercial mail receiving agencies to forward the mail of a CMRA customer without paying an appropriate fee to the Postal Service for that consideration. We believe the key word here is "commercial." When the customer of a *commercial* mail receiving agency—and I emphasize the word "commercial"—elects to conduct his or her postal business with a CMRA, instead of the U.S. Postal Service—and assuming a CMRA receives box rent or other fees for doing so—the Postal Service, in our view, should not be required to forward such mail without an additional fee being paid to the Postal Service. This is a basic *service* issue, Mr. Chairman, and *service* is what the Postal Service is—or should be—all about.

We have noted the inclusion of a new Section 307, titled "Suits," in the language of the legislation. Specifically, at Section 307(f)(1), the Postal Service would be required to comply with all zoning, planning and land use regulations and building codes applicable to state and local public entities. While we can appreciate the public-interest representation of such a provision, Mr. Chairman, we are concerned that overly stringent interpretations and applications of such regulations and codes could serve to thwart a community's access to modern and efficient postal facilities, products and services. Rather than requiring the agency to, without contest or appeal rights, comply with all such regulations and codes, we would offer the following amendment: Before the phrase "comply with all..." insert the words "shall make every reasonable effort to faithfully..."

Because postal supervisors and other first-line managers are willing partners of the Postal Service's management team, NAPS respectfully defers to the Postal Service with respect to further amendments to H.R. 22 the agency deems well-advised. It is our

expectation, Mr. Chairman, that your Subcommittee will give the same thoughtful and serious consideration to these proposed amendments as you have to the many others presented to you since H.R. 22's predecessor bill was introduced in the 104th Congress.

Having said that, NAPS respectfully asks to reserve the right to review and submit comments on the final language of H.R. 22 that is reported by the Subcommittee.

In closing, Mr. Chairman, I caution that, as we focus on the details of H.R. 22, as clearly we must, we do not at the same time lose sight of what we're putting together here. Accordingly, I must respectfully pose to you and your distinguished colleagues a question of overriding concern to me. You can call it "food for thought."

I'll state it as simply as I can. As we rush headlong into creating a Postal Service that walks, talks and otherwise operates like a public corporation, are we truly crafting an entity that has a genuine chance of survival? More to the point, Mr. Chairman, what commercial enterprise in this country would remain in business long if its officers had to operate under a host of federal statutes governing the types of products and services it could offer and at what price, and under the watchful eye of—all at the same time—a Board of Governors *or Directors*, a Postal Rate *or Regulatory* Commission, an Inspector General and, with all due respect, a congressional oversight committee or two? I pray you know the answer to that question.

Thank you, Mr. Chairman, and members of the Subcommittee. It is always a privilege for me to represent the first-line managers of the Postal Service whose unwavering belief in the future of postal service in this great country may be summed up with three words: affordable, competitive and universal.

I'll be happy to take your questions.

Mr. McHUGH. I think to President Palladino's last comment, as you read it into the record, I would simply say and respond with another question. What commercial enterprise continues to operate under the same set of regulations, guidelines and mandates that it did nearly three decades ago? What we're faced with here is the U.S. Postal Service is, indeed, that kind of enterprise.

The road to hell, as I said in the past, and I didn't make this up myself as you know, is paved with good intentions. Recognizing that, the intention has always been at the core of this to preserve and to ensure the continuation of the kinds of services that President Carrico, particularly, raised in his testimony a few moments ago. That provision in places like Pierrepont Manor, and what a coincidence you mentioned that first, I was stuck by that, and in places like Philadelphia, PA.

I go to a small post office when I'm home every day. Mary Ann Aubin, the postmaster, is an important part of that community and does a terrific job. I have a perspective and place a value on that that may or may not be unique. I suspect it isn't. I suspect most Americans view their postal employees and view the postal workers almost as a part of their family because they see them with such frequency.

And I think that's reflected in the polling data. Politicians do indeed pay attention to polling data. We only tend to talk about the ones we like, but clearly the vast majority of Americans have a great deal of admiration for what you do and who you are. We respect that and not only respect it, we would want to make every effort to continue it.

But I think, as you know, the pressures that the Postal Service is coming under, and the pressures we know are down the line with respect to new types of communications, are really going to demand some kind of change. Whether we do it in H.R. 22 in an atmosphere of relative calm, or whether we do it, as occurred back in the 60's, in an atmosphere of crisis is our choice. And we'll see which path we'll choose.

But let me just ask you to comment on the few of the specifics that you mentioned both as you presented your summary and your written testimony, because the comments that you made, I think, are important ones. I want to be able to reconcile on the record what we believe is not just the intention, but the effects of H.R. 22, versus what you interpret and you have stated some concerns. President Cinadr, for example, you just said that this bill could become a vehicle by which we undercut the provisions and the forces of the 1970 act. I was curious, the "basic principles," I believe is the phrase you used. Could you explain or kind of expound, or expand upon rather, on what provisions of the 1970 act do you think were jeopardized? Because if that's the case, we indeed need to take a very careful look at that.

Mr. CINADR. Well, I think it reflects on the universal service requirement, that the Post Office is unique in having that responsibility. I am concerned about how the funding of the private corporation would affect universal service. And I believe you did address that issue with the prior panel, with the Postal Rate Commissioners. So, as you are well aware, I prepared this testimony before knowing what they were going to say.

Mr. MCHUGH. Right. So am I hearing, and that's totally fair if it's true, that you learned some things that at least lessened or narrowed that concern?

Mr. CINADR. Yes.

Mr. MCHUGH. OK. Well, good. All of you, all of the presentations in one way or another, some a little bit more directly than others, voice again concern about how this bill may, the phrasing used, "re-regulate" or "regulate" the Postal Service as it does not currently exist. Concerns, understandably, about turning over to non-postal individuals control of issues like pay, and employee working conditions, and such, that would be enormously troubling to me as well.

And I very much would want to meet those concerns. So I'm wondering if you could define for us some of the specific parts of the bill that you think do that so that we could take a further look at those? President Carrico.

Mr. CARRICO. Could you clarify your question please?

Mr. MCHUGH. Well, all of you had said that the bill could re-regulate and as another step put non-postal people in control of issues like employee wages. For example, President Cinadr says we could penalize postal employees in some aspects of H.R. 22.

I'm just trying to understand if you are concerned about that happening, and I don't have a problem with that. Change is always an issue for concern. If it is a matter of your being troubled by doing it differently and possibly something happening bad, I'm Irish Catholic, I know how that works. I sit home and think about that every night.

However, if there are specific provisions of this bill that in your view, for example, as was stated, gives further control of the Congress to meddle, as President Carrico suggested in his testimony, to meddle in the Postal Service, that's not our intent. If there are provisions in the bill where we can go in and alleviate your concern, we want to do that. So I'm just trying to pinpoint—

Mr. CARRICO. I see what you are getting at now. Yes. I believe there is a problem with the PRC appropriation. I think we can springboard off Chairman Gleiman. Chairman Gleiman really is the watch dog and I think he's done that very well.

I have some concern that if the bill authorizes congressional appropriations, more congressional micromanagement would result. And I don't think that's anything that we need. The PRC is doing a great job protecting our interests there right now.

Mr. MCHUGH. So the provision of the bill that calls for a change in how the Postal Rate Commission receives its funding, currently it comes through the Postal Service, we would now have it as an appropriation from Congress, concerns you because you think Congress could then use that to control the Postal Service?

Mr. CARRICO. Well, I think that's what the Postal Reorganization Act in 1970 did was it took it out of the hands of Congress. Now it seems to me like this part wants to come back in. That also could make funding and different appropriations become more political and our competition could use their political clout to drive a wedge in there.

Mr. MCHUGH. But that happens right now. You need only to go to last year to see that, under the Postal Treasury Appropriations

bill, a provision was presented to affect everything from your pack-and-send to international mail and the international postal union. So I understand what you are saying but I want you to be assured, and this isn't of much comfort, that we're not going to do anything worse to you under this bill than we already do.

Mr. CARRICO. And that concerns me.

Mr. MCHUGH. And that appropriation to the PRC is not, as you understand, not a direct appropriation to the Postal Service, obviously.

Mr. CINADR. Mr. Chairman.

Mr. MCHUGH. Sure.

Mr. CINADR. I view my testimony as my opportunity to express to you and the other members of the committee what the concerns and the worries of my constituents are, and those are the postmasters of this country. And I defend postmasters of this country to the utmost. And if I sound too proud, I've spent 37 years in the Postal Service and I am very proud of what it has done, what it accomplishes, and what it continues to accomplish under the present set up.

I am concerned on how that will change and what effect it will have on postmasters and the rest of the postal community. And the point I'm trying to make is that we are presenting a level view of the playing field, and I don't see that when my competitors testify.

Mr. MCHUGH. Well, as you will find, those who are on the other side of the fence in this equation are not particularly happy in all aspects of the bill either, which in this town means that maybe we're on to something. But, first of all, you have not only every right but every reason to be very proud of nearly four decades of service in the Postal Service. Those of us who are in politics wish we had half as much to be proud of as you do.

And I do not for a moment, gentleman, question not only again your right but your responsibility to view concerns that are held by your members. You've all done that very, very well, and I commend you for it. The main point I wanted to make as I read your testimony is not objecting to the concerns you share, but trying to make it clear to you that if you have specific concerns in the bill that we can talk about and address, we want to do that. Because, and let me narrow it, my objective is much along the lines of yours, to ensure that universal service at a uniform price continues as it has in the past.

So that when I go to the post office in Pierrepont Manor, No. 1, it's there and it's open and No. 2, that I can receive the mail in the effective, efficient, affordable way I can today. I mean that's the underlying premise here.

So we want to be able to work with you. Where you have concerns of a specific nature, we would not just encourage you but plead with you to come with us and share those and we'll do everything we can to work that out. That's all I wanted to say on that. President Carrico, you look like you want to say something?

Mr. CARRICO. Yes. I would like to look at the double postage rule on the priority mail because I do have some concerns on that one also. And I guess my concerns, again, go back to rural America. Priority mail is a very popular product both in the cities, but primarily in the rural areas, because it does speed up the service.

It would be very easy for me to deliver 1,000 pieces in Washington, DC, and make a pretty decent profit. But for me to deliver 1,000 pieces in rural America, it would be very difficult to make a profit. Under the bill, I think there is a six-time postage rule which would make postage for priority mail go as cheap as \$1.98. I think that could really have some devastating effects on some of the outlying areas. And I think priority mail as a product that we know today would probably dwindle, if that were to occur.

Mr. MCHUGH. I understand that. No. 1, I think it's instructive that the Postal Service has not objected to that provision. And I think the reason is simply that, once you are through all the math calculations, the result of that is that it puts into play only 3 percent of the current monopoly business that you hold.

But, most importantly, and I think if you went and talked to the Postmaster General and others, the reason they support that 3 percent that it puts into play, it doesn't mean you are going to lose it, just that there is now open competition on that 3 percent. That in return for that they receive a substantial menu of competitive tools that they now don't enjoy. So you know—

Mr. CARRICO. It's a tradeoff.

Mr. MCHUGH. It is. And I'm not trying to shoot down the Postal Service's position here, but any time you can retain 97 percent of what you got and get back quite a bit in return, that's a probably pretty good deal. And it's probably what we're going to hear as some of the opposition to this bill, but I won't tell them, if you don't. OK? But I understand your concerns, I think.

We, I should note, have been joined by Representative Danny Davis, from the great State of Illinois, who has been a loyal and very productive member of the subcommittee, and we welcome him back this year. I would, at this time, yield to the ranking member, the gentleman from Philadelphia, Mr. Fattah.

Mr. FATTAH. Thank you very much. I'm trying to see if we can just identify—let me start here. I know we all have a tremendous amount of appreciation for the work and labor that's been put into developing H.R. 22 to this point. But we still need to understand where there are disagreements or concerns, because to the degree that this train leaves the station, you know, it is something that your Members are going to have to live with and the public is going to have to live with for a very long time.

So I'm going to see if we can crystallize, to whatever degree it's possible, some of these issues. Now, as I stated in my opening statement, and I think that is a concern of the chairman, this question of universal service and whether or not there is anything in H.R. 22 that creates concerns, legitimate concerns down this road, that somehow the Postal Service requirement and burden in terms of universal service would be infringed upon in any way, shape or form.

So I'd like to see if each of you would just make a comment on your view, relative to the universal service and the reforms or the changes as outlined in H.R. 22. Let's start with President Cinadr.

Mr. CINADR. The problem I see is, again, how the funds if this private corporation is set up, how they would be used. And when I look at how funds are used in private corporations today, I see much the same testimony that Mr. Gleiman gave, that is that part

of those funds are used to, obviously, pay back stockholders or shareholders, and part of them are used to reward the successful employees of that company. And, as I've stated before, if the bill is going to address the other use of that fund to support the infrastructure, then I believe that would be the correct way to go.

Mr. FATTAH. The requirement in the bill, as drafted, first things first, is that there would be a study done to determine the parameters about what should be universal service.

Mr. CINADR. OK. Maybe the biggest problem with testifying here today was my information was that this bill was in a state of flux or very fluid. And that's why I have pointed out the main concerns of postmasters, rather than getting into specifics of the bill.

Mr. FATTAH. I understand.

Mr. CINADR. OK.

Mr. FATTAH. Do you have any other comments, President Cinadr?

Mr. CARRICO. My only concerns are that when you are talking government agency and the private sector, the private sector is going to go where the money is. And if they take that part of the market and just leave rural America, my concerns are really what's going to happen to the postage rates. I think the way it is addressed on universal service, you guys are on top of that.

I don't have a problem with that part of it but that's something that we always need to be aware of. And I know earlier in the testimony we talked about airline deregulation and what that's done to rural America. Those are things, the potential is out there, but I don't have great concerns. I know you guys are aware of those.

Mr. MCHUGH. Vice President Keating.

Mr. KEATING. I don't have anything to add to that, no.

Mr. MCHUGH. OK. Thank you.

Mr. FATTAH. I yield.

Mr. MCHUGH. Thanks, gentlemen. Mr. Davis.

Mr. DAVIS. Thank you very much, Mr. Chairman. Mr. Palladino, you mentioned—

Mr. KEATING. Mr. Palladino is not here. My name is Ted Keating, I'm representing Mr. Palladino.

Mr. DAVIS. OK. In Mr. Palladino's testimony he mentioned concerns about labor management relationship and the various summits that netted perhaps some results. That still constitutes a big part of the discussion and a big part of the problem. Do you have any suggestions or recommendations in terms of how some recourse of movement toward solution could be built into the legislation that we're discussing?

Mr. KEATING. Not directly into legislation, sir. But I believe we commented in President Palladino's testimony that the summit, which I believe was Congressman McHugh's idea, seems to be working.

I give you the background that I've only been in this position for 6 months, so I've only been to meetings that took place in that last 6 months. But I have seen signs of progress. And the very fact that you have management organizations, the Postal Service, and all of its respective unions sitting at the table together, that's the direction to go and I believe we should continue that.

Mr. DAVIS. Let me just ask one of the other gentlemen. I also got this notion that training requirements may have something to do with the level of difficulty that's being experienced, and especially for management personnel or supervisory personnel.

Mr. CINADR. I'm not sure where you are going with that, but I would say that my personal experience with the summit meetings is that, again, I would compliment the chairman for that idea. I think it is working, we are making progress, that we do need to take the lessons that we are learning from the summit meeting and possibly utilize them in the structure of the Postal Service, in particular with the Board of Governors.

Mr. DAVIS. Go ahead.

Mr. CARRICO. I do think that the summit process is a system that's bringing us together. I probably share a different view than either of my colleagues. If there is one item that affects postmasters that keeps us apart right now, it's the pay system, the way we consult—and we use the word “consult” because I get chastised if I use the “N” word, “negotiate”—because we don't have any real power to determine the basis of our pay systems.

Back in 1970, NAPUS was the only organization that supported postal reorganizations. And as a result of that, we are the only organization that does not have some kind of third party intervention in pay consultations. I say “we,” I mean the postmasters are the only party that does not have some kind of third party intervention. At the last pay talks, it's the first time in history that postmasters did not reach a pay agreement. And there is so much ill will out there as a result of that, that it's tearing us apart. The pay package that they imposed on, especially, our lower level postmasters did not do what it was supposed to do. They said they wanted a teamwork incentive program. And they provided a program called EVA that rewards the people at the top tremendously, several thousands of dollars. And then at the very bottom end of the scale, the people who are doing the work, they may get a couple of hundred dollars.

The whole pay system needs to be looked at as far as managers. Through the summit process, I did ask for mediation. And I've been in the dog house with headquarters ever since. But I've asked, through Congressman McHugh's office, that GAO look at that pay practice. And you are doing that, and I thank you for that. I know it's not going to be 100 percent my way and it doesn't have to be that way, but it needs to really be looked hard at.

Mr. DAVIS. Let me ask either one of you gentlemen, there is a lot of conversation about price caps. And, of course, many people think that when you talk about price caps that you are also talking about wage caps, that you can't go up one way unless you are going up the other way. Could you respond to the impact you feel that price caps may have on the ability to bargain wages?

Mr. KEATING. Speaking for my organization, I'm not sure it's relevant. I don't have a concern in that area.

Mr. CARRICO. I think I would echo that too, that price caps probably more affect our colleagues in the unions more than they do us.

Mr. DAVIS. So you have no real concerns about the price cap notion. Thank you. Thank you very much, Mr. Chairman.

Mr. MCHUGH. Thank you, Mr. Davis.

[The prepared statement of Hon. Danny K. Davis follows:]

Statement of Danny K. Davis
HR 22 Postal Reform Hearing
February 11, 1999

I would first like to thank Chairman McHugh for recognizing me and allowing me the time to speak on this important matter, HR 22, the Postal Reform Act. This is one of the biggest measures aimed at "reforming" or "revamping" if you will the United States Postal Service. I would also like to thank all of our witnesses for taking the time out to come before us today. I am very interested in hearing from all of you and engaging in a sort-of "information sharing" process

Last year, we passed out of this subcommittee an amended, HR 22, and I am pleased to know that the Postal bill dropped in the 106th by Chairman McHugh reflects those changes. The amendments I offered last year seek to reflect some of my highest priorities as a Member of this Sub-committee as well as a Member of this body. Those amendments addressed the issue of jobs, good jobs—union jobs and how they relate to displaced workers as a direct result of privatization and/or the improved technology of the USPS; I also addressed the issue of a fair and reflective diverse workforce in all aspects of the Postal Service—especially in Senior Executive level positions; and finally, supplier diversity—those companies that do business with the Postal Service.

At the heart of this bill, as this committee deliberates on how to make the postal service "compete" more efficiently as a governmental entity with its "corporate competition"—if you will . . . I want to caution and remind my colleagues, let's not get away from what the Postal Service's number one priority ought to be—Delivering mail to the consumer—efficiently and effectively. This means ensuring that urban and rural can get the mail for the same price and at the same time.

Delivering the mail to the elderly man that lives in rural Arkansas and counts on his letter from his grandson has got to be just as important as getting that mail overnight from the gold coast in downtown Chicago to Washington, D.C. This, I submit, is the fundamental business of the United States Postal Service and should be the most important to maintain.

Thank you very much and I yield back the balance of my time.

Mr. MCHUGH. Gentleman, I appreciate your being here. And at the risk of being incredibly repetitive, nevertheless, I'll say it again. As you go through this and you do have specific concerns, as those understandable and very legitimate general concerns crystallize, as I hope they won't but as they may, that you feel free to come to us and try to see if there is some way that we can work through those.

To Vice President Keating, I would tell you that no representative of the National Association of Postal Supervisors has done as good a job as you. I would tell you that but your president, Vince Palladino, has come into the room and I wouldn't dare say that because of the great job he has done.

Mr. FATTAH. Could I just ask a quick question?

Mr. MCHUGH. Sure.

Mr. FATTAH. President Carrico. At this point in time, universal service, as you understand it to be maintained by the Postal Service, means what?

Mr. CARRICO. Universal service means that each and every community would maintain a post office, that they would maintain frequent delivery just like we have now. I don't feel that people should be penalized for living in rural America, that they are entitled to the same service that is given to the——

Mr. FATTAH. The same service at the same price?

Mr. CARRICO. Yes.

Mr. FATTAH. Thank you.

[Additional questions submitted for the record to Mr. Carrico and Mr. Cinadr follow:]



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April 26, 1999

Representative John McHugh
Chairman
House Subcommittee on the Postal Service
Washington, D.C. 20515

Dear Chairman McHugh:

I have attached my responses to the follow-up questions to the February 11 Postal Subcommittee hearing posed by members of your Subcommittee.

I appreciate your consideration.

Sincerely,

Ted Carrico

Ted Carrico
President

Questions

Panel Three - Postal Management Organizations

Q. A recent AP poll stated that three-fourths of Americans believe the postal service is doing an excellent or good job. Will the general public, the “Aunt Minnies” of the country support H.R.22? What’s in it for them?

The AP poll went on to say that the cost of stamps is too much. Any idea how much Aunt Minnie will pay for postage under H.R. 22?

Q. If we were to enact H.R. 22 today, as currently written, how would postal jobs and services be impacted?

Q. How will the postal service address collective bargaining and wage issues under H.R.22?

Q. Last month the GAO issued a report describing the major performance and management challenges that need to be addressed if the postal service is to sustain performance and remain competitive into the 21st Century.

In what ways can the postal service further reduce costs and what savings can be realized from the ways you have mentioned?

Q. Can we in the Congress provide the postal service greater flexibility to set rates and offer new products quickly, without the establishment of a new price cap rate setting mechanism and the

creation of a Private Law Corporation? If not, why not? If so, how?

Q. The postal service is grappling with labor-management issues, the challenges on containing costs, the need to better protect revenues, the need to implement reliable indicators of postal performance and risks from Y2K computer problems. Can we expect the postal service to address all these very serious matters and be subject to the type of postal reform envisioned in H.R.22?

Q. Commissioner Goldway, in her testimony, makes a number of very laudable comments and suggestions relative to postal reform. I would like your reaction to some of her thoughts:

“H.R. 22 should rely more on the advantages of competition than protecting the marketplace from possible postal service competition.

H.R. 22 should encourage the postal service to be more efficient and innovative.

I would propose loosening the definition of postal product in H.R. 22....to allow for product innovation where there is a nexus to postal operations, and where the postal service can show that the new product will benefit from postal service scale or scope economies.

We should not curtail the ability of the postal service to be innovative just because of its size. As the Supreme Court has said, ‘low prices benefit consumers regardless of how those prices are set, and so long as they are above predatory levels, they do not threaten competition.’ Further, it has said, ‘it is in the interest of competition to permit dominant firms to engage in vigorous competition, including price competition.’”

What is your reaction to these excerpts of Commissioner Goldway's testimony?

Q. Should Congress provide more of a public oversight role to assist the postal in better controlling costs and improve productivity?

Q. Do we need to pass H.R. 22 to effect postal reform or can we work within the existing statute to bring about changes and improvements in postal structure and operations. If so, be more specific.

Q. Currently, postal workers participate in the Federal Employees' Health Benefits Program (FEHBP) and in the Federal Civil Service Retirement program. What happens to postal worker's health and retirement benefits under the Private Law Corporation?

**Ted Carrico, President of the National Association of Postmasters of the
United States
Responses to follow-up Questions
Postal Subcommittee Hearing of February 11, 1999**

1. The deep reservoir of public support for the Postal Service is attributable to the efforts that its employees make to provide letter and package services to the entire country in nondiscriminatory way. To the extent that H.R. 22 does not erode the financial support for universal postal services "Aunt Minnie" will not oppose postal modernization. However, residential postal patrons and the mailing community will not support legislation that will undermine the Postal Service's capability to continue offering the type and quality of Postal Service to which they have grown accustomed.

I strongly disagree with the AP respondents who asserted that postage rates are too expensive. The U.S. has the largest number of delivery points in the world. These points include urban, suburban and rural addresses. Nonetheless, the U.S. has the most efficient and reliable postal service in the world. Furthermore, postage rates remain one of the least expensive in the world.

2. As the Postmasters have stated in our prepared testimony, we are actively engaged in helping to improve the legislation so that, if enacted, H.R. 22 would not adversely affect postal service jobs and services.

3. Postmasters do not currently enjoy collective-bargaining or any type of third-party intervention. Therefore, this question does not directly apply to us. However, NAPUS urges Congress to provide the same wage, benefit, and working-condition protections that are guaranteed to other management-level employees of the Postal Service.

4. Postmasters will continue to work with postal management to explore unrealized efficiencies that can be accomplished without jeopardizing service to our patrons and the mailing community. Staff positions could be trimmed and the savings put back into operations.

5. Price indexation is the simplest way of assuring the mailing community of rate predictability. At the same time wide rate bands in which the Postal Service may set rates provide the Postal Service the price flexibility in needs to remain viable in the dynamic communications marketplace.

The establishment of the Postal Private Law Corporation creates many very valid questions as to the status of employees who work for that institution, including its impact upon employment within the U.S. Postal Service. Postmasters look forward to working with the Committee to help resolve these concerns.

6. I believe that Congress must balance the needs of the different interests within the mailing community (e.g., residential patrons, business mailers, nonprofit organizations, etc.). Clearly, the

Postal Service needs to respond more quickly to the dynamic communications market. The Service needs to respond new market demands, as well as respond to price aggressively competitive products. H.R. 22 provides a reasonable framework for accomplishing this goal.

7. Commissioner Goldway captures the essence of why the Postal Service must be innovative, and requires the tools to develop and market new postal products unencumbered by intervention from for-profits competitors of the Postal Service. Nonetheless, Postmasters would be very cautious about any further loosening of the private express statutes.

8. Congress oversight is not the issue. Periodically, Congress should conduct responsible oversight of the Postal Service. After all, the Postal Service is the only player in the communications and delivery market who operates as a public service – not to make a profit for its shareholders.

9. There are a number of statutory impediments that preclude the Postal Service from operating in the most effective fashion. For example, the law prohibits the Postal Service from providing volume discounts to large mailers, including the federal government.

10. We would support employees of the PLC retaining the status as employees of the Postal Service, under the supervision of Postmasters.

3/99

Questions

Panel Three - Postal Management Organizations

Q. A recent AP poll stated that three-fourths of Americans believe the postal service is doing an excellent or good job. Will the general public, the "Aunt Minnies" of the country support H.R.22? What's in it for them?

The AP poll went on to say that the cost of stamps is too much. Any idea how much Aunt Minnie will pay for postage under H.R. 22?

Q. If we were to enact H.R. 22 today, as currently written, how would postal jobs and services be impacted?

Q. How will the postal service address collective bargaining and wage issues under H.R.22?

Q. Last month the GAO issued a report describing the major performance and management challenges that need to be addressed if the postal service is to sustain performance and remain competitive into the 21st Century.

In what ways can the postal service further reduce costs and what savings can be realized from the ways you have mentioned?

Q. Can we in the Congress provide the postal service greater flexibility to set rates and offer new products quickly, without the establishment of a new price cap rate setting mechanism and the

creation of a Private Law Corporation? If not, why not? If so, how?

Q. The postal service is grappling with labor-management issues, the challenges on containing costs, the need to better protect revenues, the need to implement reliable indicators of postal performance and risks from Y2K computer problems. Can we expect the postal service to address all these very serious matters and be subject to the type of postal reform envisioned in H.R.22?

Q. Commissioner Goldway, in her testimony, makes a number of very laudable comments and suggestions relative to postal reform. I would like your reaction to some of her thoughts:

"H.R. 22 should rely more on the advantages of competition than protecting the marketplace from possible postal service competition.

H.R. 22 should encourage the postal service to be more efficient and innovative.

I would propose loosening the definition of postal product in H.R. 22....to allow for product innovation where there is a nexus to postal operations, and where the postal service can show that the new product will benefit from postal service scale or scope economies.

We should not curtail the ability of the postal service to be innovative just because of its size. As the Supreme Court has said, 'low prices benefit consumers regardless of how those prices are set, and so long as they are above predatory levels, they do not threaten competition.' Further, it has said, 'it is in the interest of competition to permit dominant firms to engage in vigorous competition, including price competition.'

What is your reaction to these excerpts of Commissioner Goldway's testimony?

Q. Should Congress provide more of a public oversight role to assist the postal in better controlling costs and improve productivity?

Q. Do we need to pass H.R. 22 to effect postal reform or can we work within the existing statute to bring about changes and improvements in postal structure and operations. If so, be more specific.

Q. Currently, postal workers participate in the Federal Employees' Health Benefits Program (FEHBP) and in the Federal Civil Service Retirement program. What happens to postal worker's health and retirement benefits under the Private Law Corporation?

**Joseph W. Cinadr's answers on HR 22 to the
Questions
Panel Three - Postal Management Organizations
April 2, 1999**

I believe most "Aunt Minnies" will remain silent on HR 22. The most vocal parties will continue to be USPS competitors – UPS, Fed Ex, Coalition Against Unfair USPS Competition, etc. If USPS loses \$17 billion in first class revenues and if the postal service is not allowed to fairly compete in Express, Priority and parcel post services, rural "Aunt Minnies" will be screaming in protest of higher rates and the injustice done to them. We should all be well aware of UPS's surcharges for residential and rural delivery.

I believe the postal service would be faced with severe loss of revenue which would result in cuts in expenses and in total employment. Service would be adversely affected and universal service would be a memory.

I believe two year agreements were recently achieved with the American Postal Workers Union and the Mail Handler's Union due to uncertainty of economic conditions and predicted first class declining mail volumes. As I cited above, employment would be seriously affected. And service would probably suffer.

Continue automation and robotics program to eliminate repetitive duties and lifting requirements. According to published figures, USPS past efforts (1987-1996) have enabled the postal service to handle 19% more mail volume with only a 10% increase in total work hours – a total savings of 57 million work hours.

Yes, give that authority to set rates and introduce new products to the Postal Board of Governors (directors). They do not need additional oversight. They are all wise in the functions of private industry. And understand the marketplace. They are knowledgeable and accountable. USPS needs more freedom to provide new products and services, not more control. Do competitors have to wait nine months to raise prices? Creation of a private law corporation and its related anti-trust liabilities would adversely affect postal revenues and increase and increase cost to consumers. No one can predict how the courts will interpret these proposals.

Continued next page.

The postal service is capable of meeting all present challenges. If USPS is granted the authority to volume discount prices – a practice already used by their competitors – USPS will be able to meet future challenges.

I believe Commission Goldway presents an intelligent and insightful view of the present and future postal service. I wish her continued success in her service as commissioner and beyond. (See recommendation for question #5.)

No, I believe the rate commission is a waste of my and every other rate payers money. The Board of Governors have oversight responsibilities. The postal service already provides oversight reports to the Congress and the President. Why are we regulating the regulators?

I would like to see two changes – volume discount pricing, and fact-finding for postmasters.

Good question. I'm sure USPS's current employees would like to know. I believe grandfathering present employees might be the best option for FEHBP, CSRS and FERS coverage's.

Mr. MCHUGH. Well, I stand corrected. My old ears heard "Vince Palladino" and apparently Vince Sombrotto has come in. So my feeble attempt at humor didn't even come close.

Mr. KEATING. Mr. Chairman, they are both from New York so you probably couldn't tell the difference.

Mr. MCHUGH. Well, we're delighted that Vince Sombrotto is with us, but remain sorry that Vince Palladino is not. But, again, thank you all very much for being here, and we look forward to continue working with you.

Mr. KEATING. Thank you, Mr. Chairman.

Mr. MCHUGH. Last, certainly not least, the four unions. The American Postal Workers Union, President Moe Biller; as I just said, President Vince Sombrotto, National Association of Letter Carriers; President William Quinn, the National Postal Mail Handlers Union; and President Steve Smith, the National Rural Letter Carriers Association.

As we're changing placards and drawing those up, we'll take about a 40-second break here.

[Brief recess.]

Mr. MCHUGH. If you'll stand, I'll administer the oath now.

[Witnesses sworn.]

Mr. MCHUGH. Let the record show all four presidents responded affirmatively to the oath. Gentlemen, welcome. We thank you very, very much for being here and we look forward to your comments. Here, too, I have read all of your prepared testimony and we will submit into the record in its entirety those submissions. I would ask if you could summarize them today. And, as in the past, we'll go by order of the announcement.

President Moe Biller, welcome. Good to see you, how have you been?

Mr. BILLER. Pretty good. A little injured knee, that's all. I broke my hearing aid, so be careful.

Mr. MCHUGH. You injured your hearing aid?

Mr. BILLER. I injured my knee and broke a hearing aid.

Mr. MCHUGH. Oh. I need a hearing aid, apparently. Well then, if I say bad things about you, I'll do it quietly. We're truly pleased you are here and, please, the floor is yours.

STATEMENTS OF MOE BILLER, PRESIDENT, AMERICAN POSTAL WORKERS UNION, AFL-CIO; VINCE SOMBROTTO, PRESIDENT, NATIONAL ASSOCIATION OF LETTER CARRIERS; WILLIAM QUINN, PRESIDENT, NATIONAL POSTAL MAIL HANDLERS UNION AFL-CIO; AND STEVE SMITH, PRESIDENT, NATIONAL RURAL LETTER CARRIERS ASSOCIATION

Mr. BILLER. Mr. Chairman, members of the subcommittee, I'm pleased to appear again before you today to represent the views of the 361,000 members of the American Postal Workers Union, AFL-CIO on the subject of postal reform and your latest proposal for reform, H.R. 22.

May 8th of this year, I will begin my 63rd year in postal activity, and 68 years in the trade union movement. Mr. Chairman, I want to make it clear that I greatly appreciate the sincere effort and concern you have brought to bear on this difficult topic. Unfortunately, as has been true with respect to similar bills that were introduced

in the last session of Congress, we still have several fundamental problems with H.R. 22, and therefore cannot support this legislation that was introduced unless these matters are corrected.

Our objections have been expressed many times before. The bill continues to have a pre-fixed formula specifying a rate cap on non-competitive mail. Unlike the telecommunications industry or other industries which have tried this form of regulation, the Postal Service remains a labor intensive operation.

From our perspective, this means that if there are unanticipated adverse changes and expenses, market demand, or competition, the Postal Service's sole recourse, if it is to stay within the cap is to impose concessions on its workers. We cannot be sure whether such concessions will take the form of wage and benefit give backs or harsher working conditions applied for the purpose of achieving greater output.

But we can be sure that in a labor intensive industry, a price cap inevitably pushes downside risk of adverse changes in price or market conditions onto workers while, as has been true over the last several years, the upside benefits of low inflation and a growing economy are retained by mailers and managers. We cannot acquiesce to the creation of this sort of scenario.

I am pleased to report to you that we recently reached and ratified a collective bargaining agreement with the Postal Service. This is the first such agreement reached without resort to interest arbitration in over 11 years. The contract was overwhelmingly ratified by 64 percent of the APWU membership. It was not easy and both sides worked hard to resolve a number of complex issues.

The wage bargaining was, of course, the most difficult problem, given the uncertainty and volatility of the worldwide economy. I cannot imagine how we could have worked our way through all of these problems if, in addition to everything else on the table, we had to factor in the potential impact and risks associated with a congressionally imposed price cap on mail services.

Indeed, it is clear to me that the existence of an external formula shifting downside risk of market and material changes onto workers will make voluntary agreements, such as the one we just achieved, far less likely and interest arbitration the inevitable norm.

While the price cap issue is our most fundamental concern, it is not our only concern. We continue to object to the bill's specification, in Section 503, that a letter may be carried out of the mail stream when the amount paid for private carriage is at least six times the postage for the first ounce of First Class Mail. While I recognize that the floor for private carriage is higher than in previously introduced legislation, the fact remains that the proposal is obviously the first step toward postal privatization. Indeed, former Postmaster General Marvin Runyon stated that this proposed rollback of the Private Express statutes places \$4 billion of the USPS' First Class Mail market at risk.

Under the present format of the bill, the impact of this loss of revenue will inevitably be borne by workers. Beyond the impact on our members, though, allowing USPS' competitors to skim the cream off of a major piece of the USPS' market, in the way proposed by H.R. 22, will obviously jeopardize the Postal Service's ca-

capacity to provide universal mail service at uniform rates. Universal postal service is a fundamental feature of American life and we cannot endorse any proposal which places it in jeopardy.

Finally, we believe the proposed study of labor-management relationships in the Postal Service by the National Academy of Public Administration, set forth in Section 601, is totally unnecessary. If the goal here is to improve labor-management relationships in the USPS, I would submit that we have made a quantum leap in that area through the recent APWU-USPS contract. This contract was, for the first time since 1987, agreed to by both parties, without the interference of an outside arbitrator.

If you think this is insignificant, then please allow me to share with you the following from the Washington Post, on January 9, 1999. "I am delighted with the outcome," Postmaster General Henderson said, "This is an agreement that is clearly in the best interests of our employees and all of America." Henderson added, "My hat's off to Moe Biller, and his negotiating team, and our negotiating team for having the patience and the forbearance to bring a long, hard set of talks to conclusion."

Labor-management relationships in the USPS have been studied to death. We are presently involved in ongoing work with the Federal Mediation and Conciliation Service to resolve long term problems. And that agency, at least, has the benefit of direct experience with resolving labor-management conflict. I see nothing to be gained by inserting yet another outside party into this mix.

Time has shown that we all do best when our efforts are focused on improving the collective bargaining relationship and our mutual capacity to resolve problems. A Republican American President with traditional conservative views, Richard M. Nixon, understood this when he approved collective bargaining in the Postal Reorganization Act of 1970. His insight is equally valid today.

To be sure, consistent with the overall goal of H.R. 22, we are interested in authorizing the USPS to enter into new markets and to compete in them. Our union has, in fact, agreed to certain competitive projects with respect to work that has been contracted out.

However, the price exacted by the bill for allowing us to compete, price caps in the USPS' major markets and yet another rollback of the Private Express statutes, is too high. Based on this, and notwithstanding its many constructive elements, we cannot support H.R. 22.

Mr. Chairman, that concludes our testimony. I would be pleased to answer any questions you or other members of the subcommittee may have.

Mr. MCHUGH. If I get a letter from Richard Nixon, will you support it?

Mr. BILLER. I'll get you that letter.

[The prepared statement of Mr. Biller follows:]



**American Postal
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Moe Biller, President
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TESTIMONY OF
MOE BILLER, PRESIDENT

AMERICAN POSTAL WORKERS UNION, AFL-CIO

ON

"THE POSTAL MODERNIZATION ACT OF 1999"

BEFORE THE

SUBCOMMITTEE ON THE POSTAL SERVICE
COMMITTEE ON GOVERNMENT REFORM
U.S. HOUSE OF REPRESENTATIVES

FEBRUARY 11, 1999

Congressional Testimony

Mr. Chairman and Members of the Subcommittee, I am pleased to appear again before you today to represent the views of the 361,000 members of the American Postal Workers Union, AFL-CIO, on the subject of postal reform and your latest proposal concerning reform — H.R. 22.

Mr. Chairman, I want to make clear that I greatly appreciate the sincere effort and concern you have brought to bear on this difficult topic. Unfortunately, as has been true with respect to similar bills that were introduced in the last session of Congress, we have several fundamental problems with H.R. 22 and, therefore, cannot support this legislation as introduced.

Our objections have been expressed many times before. The bill continues to have a prefixed formula specifying a rate cap on "non-competitive" mail. Unlike the telecommunications industry or other industries which have tried this form of regulation, the USPS remains a labor-intensive operation. From our perspective, this means that if there are unanticipated adverse changes in expenses, market demand, or competition, the Postal Service's sole recourse — if it is to stay within the cap — is to impose concessions on its workers. We cannot be sure whether such concessions will take the form of wage and benefit givebacks, or harsher working conditions applied for the purpose of achieving greater output. But, we can be sure that in a labor-intensive industry, a price cap inevitably pushes downside risk of adverse changes in price or market conditions onto workers while — as has been true over the last several years — the upside benefits of low inflation and a growing economy are retained by mailers and managers. We cannot acquiesce to creation of this sort of scenario.

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obviously jeopardize the Postal Service's capacity to provide universal mail service at uniform rates. Universal postal service is a fundamental feature of American life and we cannot endorse any proposal which places it in jeopardy.

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Mr. Chairman, that concludes our testimony. I would be pleased to answer any questions you, or other members of the subcommittee, may have.

Subcommittee Follow-up Questions (H.R. 22)

1. What is the connection and or similarity between price caps in the telecommunications industry and price caps in the Postal Service?

There are few similarities. The telecommunications sector has been privately owned and operated for over one hundred years. The Postal Service is not. Telecommunications labor unions are permitted to strike; the APWU is not. Price caps were not legislated upon the telecommunications industry, which permitted quick cessation and alteration of price cap regulation in some cases. There is no consensus among experts in the telecommunications industry that price cap regulation has performed better than other forms of regulation, or for that matter, than deregulation.

Unlike the telecommunications industry, the Postal Service is not a capital-intensive industry and thus is not suitable for price cap regulation. Despite the difference in capital-intensity, of the seven hundred local telecommunications carriers in the U.S., only a handful are price cap regulated. If price caps do not work for most telephone companies, then how will they work for the labor-intensive Postal Service?

These points are explained as follows:

Regulated Industries with Technical Change, Capital-Intensity and High Productivity Growth Are Better Candidates for Price Caps

The telecommunications sector has experienced strong productivity gains under both rate of return and price cap regulation. This telecommunications productivity growth has been fueled by technical change. High capital-intensity and technological change has had major impact on the per unit cost of production. For example, step-by-step switching was replaced by crossbar, electromagnetic and digital systems. Analog systems, antiquated by the advent of computers, have been substituted by digital technologies. Computer output, as measured by instructions per second, has increased hundreds of times. With the right electronic equipment, the bandwidth of a single copper pair has increased 100 times in the last decade. Now fiber optics is making copper obsolete in some markets, as it did to microwave technologies in the 1980s. Technological enhancements, such as wave division multiplexing, have increased existing capacity manyfold without increasing investment in copper or fiber plant.

These enhancements have little impact on Postal Service costs, because these are not primary inputs to Postal Service production. The Postal Service is very labor intensive, with labor accounting for 80% of input costs. So the ability of the Postal Service to take advantage of this technological change is limited, as it is for most labor-intensive industries. This explains why labor-intensive industries have lower gains in productivity than capital-intensive industries. It is the nature of production. Therefore, the Postal Service is not a good candidate for price caps.

Legislating Price Caps Did Not Occur in Telecommunications

The first notable use of price caps was in 1990, as a means to automate the regulation of AT&T's interstate toll services. Proponents of price caps predicted cost savings from reduced regulatory surveillance; however, no regulatory savings have ever been observed. Just six years after it began, the FCC ended AT&T's price cap regulation. Its usefulness had disappeared quickly. It should be noted that if price caps had been legislatively mandated upon AT&T, this early cessation of regulation would not have occurred. The lesson to be learned from this is that legislating price caps does not work. Regulatory flexibility is needed.

Price Cap Regulation Does Not Have Widespread Use In Telecommunications

In 1991, after AT&T, the FCC and state regulatory commissions imposed price cap regulation on a few local exchange companies. Today, the FCC regulates little more than 1% of the local exchange companies by price cap regulation. In the states, price cap regulation is used mostly for the large regional/local phone companies, while many state commissions do not use price cap regulation at all. We know of no small or rural telephone companies regulated by price caps. Therefore, while price caps are used to regulate some local exchange services, their use is far from ubiquitous. The lesson here is that, in many instances, regulatory commissions have chosen not to regulate by price caps, even for very capital-intensive telecommunications firms.

Work Stoppages

Under price caps, profits increase in direct proportion to wage decreases. In telecommunications, work stoppages are frequent, but for the Postal Service they are prohibited. If price caps are instituted in the Postal Service, the added profit incentive and pressure to suppress wages will be met with no countervailing force in collective bargaining. The result will expose postal workers to cuts by the Postal Service in pursuit of profits. The collective bargaining process will be harmed, and the result will be a transfer of income away from workers.

2. **Would you support a streamlined postal reform bill which would only address pricing flexibility and give the Postal Service the authority to offer new products in a more timely fashion?**

Yes, because it is a step that introduces market reforms, permits more efficient cost-based pricing and the introduction of innovative services — all of which increase consumer welfare. Reforms should find ways for the Postal Service to become more successful and share that success with employees and consumers. Success is not measured by cost — cost that could jeopardize services — but from pricing flexibility to retain and grow revenues. This will lead to a win-win situation for consumers, employees and management.

3. **Should Congress have more of a public oversight role to assist the Postal Service in better controlling costs and improve productivity?**

Congress has, over the years, exercised its oversight role appropriately. We see no need for greater Congressional involvement.

4. **Do we need to pass H.R. 22 to effect postal reform, or can we work within the existing statute to bring about changes and improvements in postal structure and operations? If so, be more specific.**

Improving under the existing structure is preferred to price caps. A compromise could be found in the answer to question #2.

5. **Currently, postal workers participate in the Federal Employees' Health Benefits Program (FEHBP) and in the Federal Civil Service Retirement Program. What happens to postal workers' health and retirement benefits under the Private Corporation?**

That would obviously be a matter for bargaining. However, using telecommunications as a guide, deregulated separate companies provide reduced benefits to their employees. Management will attempt to use a substitute workforce with lower pay, benefits and retirement — even if this sacrifices quality of service — in order to maximize profits.

6. **A recent AP poll stated that three-fourths of Americans believe the Postal Service is doing an excellent or good job. Will the general public, the "Aunt Minnies" of the country, support H.R. 22? What's in it for them? The AP poll went on to say that the cost of stamps is too much. Any idea how much Aunt Minnie will pay for postage under H.R. 22?**

As far as price caps are concerned, there's nothing in it for Aunt Minnie. Assuming that the inflation and productivity factors in the price cap are accurately set, which no one has demonstrated would occur under the proposed bill, the price cap index is designed to produce nothing better than the current system of regulation in terms of price change. Instead, the price cap creates incentives for the Postal Service to cut corners on service and reduce labor costs — all of which creates profits.

If the inflation and productivity factors are not measured correctly, then gross inefficiencies can occur by hurting employees or consumers.

7. **If we were to enact H.R. 22 today, as currently written, how would postal jobs, services and postage rates be impacted?**

This was addressed in answers #5 and #6. As mentioned, if the price cap inflation and productivity factors are representative of historical rates of change, consumer prices will be no better off under current regulation versus price cap regulation. However, if the Postal Service profits from reducing quality of service, then consumers will be worse off. If the Postal Service profits from cutting the workforce or paying workers less, then workers are worse off. Therefore, while consumer prices should change at a rate similar to historical trends, jobs and service quality will decrease under price cap regulation.

8. **How will the Postal Service address collective bargaining and wage issues under H.R. 22? How will collective bargaining be addressed under the Private Law Corporation?**

See answer #5 regarding price cap impacts on wages, benefits and retirement. As mentioned in answer #1, profit incentives created by price caps will put labor at risk in terms of work force cuts and meager wage treatment. Because postal workers, unlike telecommunications workers, do not have the option to strike, labor does not have any leverage to offset management's added profit incentives. Therefore, collective bargaining will be hampered under price caps.

9. **Ted Carrico, President of the National Association of Postmasters of the U.S. expressed a deep concern about the direct appropriation for the PRC. He believes that a connection between Congress and the PRC is dangerous because of the potential for congressional "mis"/micro management of the Postal Service and will serve as a new avenue for postal competitors to cripple the Postal Service. Your reaction?**

This is a legitimate concern. Obviously, the USPS will be harmed to the extent its operational and bargaining decisions are driven by political pressure brought to bear by USPS competitors.

10. **Last month the GAO issued a report describing the major performance and management challenges that need to be addressed if the Postal Service is to sustain performance and remain competitive into the 21st Century. In what ways can the Postal Service further reduce costs and what savings can be realized from the ways you have mentioned?**

Reduce Outsourcing

A reduction of outsourcing may be another area of cost improvement. Currently, the Postal Service makes assumptions about the cost of outsourcing and compares this with the loaded cost of providing the service in-house. There is no evidence that the outsourcing assumptions achieve the contract prices for the outsourced service. In other words, in the end, the Postal Service may be paying more for contract service than it assumed when making its decision to outsource. Furthermore, including indirect costs when evaluating company-provided services means that outsourcing will not result in the full savings to the Postal Service. Hence, this costing approach leads to wrong business decisions — higher costs and less benefit. The Postal Service should reevaluate its outsourced services by using incremental methods, which exclude any joint or common cost not directly associated with the service in question. We recommend the following:

- All outsourced services should be compared to in-house provision based on incremental costs. This will provide for better business decisions. If wrong decisions were made, the Postal Service should remedy this. This approach should be used in any future decisions as well.

- All outsourced services should compare actual cost performance to original estimates. This will assure that costing methods are not built on assumptions that cannot be later realized. Again, if wrong decisions were made, the Postal Service should remedy this.

Universal Service Cost Support

The most important cost problem for the Postal Service is the payment of subsidies to high cost areas. We recommend that competitors and incumbents pay into a national fund that compensates high cost areas, as occurs in state and federal telecommunications universal service funds. For example, all players who want the business/package and overnight delivery services, since these low cost services are better able to support high cost services, should pay into such a fund.

Today, the Postal Service provides the entire subsidy itself, making it more vulnerable to cream skimming. Permitting cream-skimming works to undermine the universal service that "Aunt Minnie" relies upon. Permitting pricing flexibility can address some of this. However, price caps and a private corporation can lead to behaviors and actions that undermine universal service. Under price caps, success is measured in profits and comes at the expense of employees and consumers.

Miscellaneous Cost Improvements

Reduce levels of management and supervision.

11. **Can we in the Congress provide the Postal Service greater flexibility to set rates and offer new products quickly, without the establishment of a new price cap rate setting mechanism and the creation of a Private Law Corporation? If not, why not? If so, how?**

Only pricing flexibility will permit *price* competition; price caps will not. For some services, to the degree that prices are slowly moved toward costs, economic benefits will increase and the Postal Service will become more competitive. Retaining revenues and creating new revenue streams is important to protecting the vitality of the Postal Service and universal service support. Pricing flexibility can facilitate this.

12. **The Postal Service is grappling with labor-management issues, the challenges on containing costs, the need to better protect revenues, the need to implement reliable indicators of postal performance and risks from Y2K computer problems. Can we expect the Postal Service to address all these very serious matters and be subject to the type of postal reform envisioned in H.R. 22?**

Pricing flexibility and the ability to introduce new, innovative products will permit the Postal Service to retain and grow revenues, as well as stimulate consumer demand. This will breathe vitality into the Postal Service and provide it with the means to meet these challenges.

On the other hand, price caps pose a number of risks because they will drive the Postal Service to produce profits, by sacrificing quality.

Mr. MCHUGH. OK. Thanks. We have a vote under way, as you've heard. We understand there will be that single vote and then more discussion on other amendments. So if we could suspend, I apologize. And, hopefully, we can move over there and vote and come back as quickly as possible. So if we could stand in adjournment for just a few moments. And I apologize, gentlemen.

[Recess.]

Mr. MCHUGH. Why don't we, with the indulgence of the minority, continue with the statements? Because, as I indicated earlier, and as he did as well, the ranking member is in another committee meeting and he is trying his best and doing very well in coming back and forth. So if we could continue with the presentations, I think we can expedite matters.

And with that, we are pleased to welcome President Vince Sombrotto, the National Association of Letter Carriers. Vince, you do not look like Vince Palladino in any shape or fashion, but we're glad you're here and we look forward to your comments.

Mr. SOMBROTTO. It's some good news if you think I'm Palladino. I just gained a number of members and I'll improve their performances in the Postal Service. I thank you Chairman McHugh and members of the subcommittee for the opportunity to discuss this important piece of legislation. I'm Vincent R. Sombrotto, president, National Association of Letter Carriers, AFL-CIO, and I'm pleased to be here representing some 310,000 members of the NALC.

A recent survey conducted by Pew Research Center for the people and the press stated that the public gave the Postal Service an 89 percent favorability rating, higher than any other Federal agency. Another study by ICR of Media, PA, said that nearly three fourths of Americans believe the Postal Service is doing an excellent or good job. This is a tribute to the hardworking men and women who make the system work on a daily basis.

As the public face of the Postal Service, letter carriers take great pride in receiving such recognition for the outstanding service we provide. While every American has come to rely on these vital services, few understand the way the USPS operates. I can even remember a time, Mr. Chairman, when you yourself acknowledged being surprised by the intricacies involved with timely and efficient mail delivery. You are to be congratulated for dedicating yourself to learning about the Postal Service and taking on this effort to enhance its performance through the introduction of H.R. 22, the Postal Modernization Act of 1999.

As the members of the subcommittee are well aware, the fundamental principle which guides the USPS is universal service at uniform rates. This means that Postal Service employees must continue to provide normal 6-day delivery to all addresses at the same reasonable rate. The public demands nothing less, and the NALC believes that any proposed postal reform must fit into that framework.

Rather than taking time today to go through the bill section by section, I'd like to focus on a few key points which are critical for meaningful postal reform. We are encouraged by some of the changes that have been made in H.R. 22 since its introduction. Chief among those is the elimination of the mailbox demonstration program proposed in the original draft of the bill.

As you know, the relationship between letter carriers and the public they serve is one of trust and security. Some of our competitors would like nothing more than to destroy that trust, sacrificing a public service in the name of profits. We view that removing of the mailbox demonstration program from the bill as an acknowledgement of the desire to maintain the high level service and professionalism the American people have come to expect from letter carriers.

We are pleased with Congressman Gilman's efforts to ensure that the proposed Postal Regulatory Commission envisioned in the bill will not undermine the collective bargaining process. The language discourages the new commission from using its expanded authority to interfere with matters best left up to labor and management representatives. We applaud this suggestion and encourage its adoption with the full force of law and not just the sense of the Congress.

Also, I'd like to thank Congressman Fattah for his proposal which would create a labor seat on the Postal Board of Directors as created in H.R. 22. Since its inception in 1971, 50 individuals have served on the Postal Board of Governors. Members of the business community, former congressional staff, and even dentists have served on the Board, but not one person has come from the ranks of organized labor. Mr. Chairman, there are hundreds of thousands of union employees within the USPS.

Sound business practice would dictate that someone serve on the Board who understands the challenges facing these hardworking employees. I know there are Members of the Congress who have legitimate concerns over reserving specific seats on the Board. At the same time, I thank the subcommittee for acknowledging the inequity that has existed for all these years.

I am aware that the Postal Service is proposing a number of changes to H.R. 22. We have recently received some of these proposed measures and are working so that we may fully understand their impact. Given their far reaching scope, it would be imprudent for the NALC to express a position on them at this time. We take these proposed changes as well intended, and are eagerly awaiting the reaction of the mailers, other customers and competitors.

While most of the groups paying attention to this bill have the public's best interests at heart, we at the NALC are concerned with some competitors of the Postal Service who are trying, at all costs, to break the Postal Service's mandate of universal service. It is imperative that H.R. 22 not become a vehicle for their self-serving attempts to weaken the Postal Service. Such an effort would undermine the constructive spirit which has characterized the healthy debate surrounding H.R. 22.

As you are well aware, Mr. Chairman, there have been questions raised recently about authority over the Universal Postal Union, much of which was initiated during appropriations process. An apparent compromise was satisfactorily reached. I think it's fair to say all sides gave a little in order to reach that point.

My concern is not over a good faith debate about proper policy and objects, instead, I would suggest these issues be considered and brought up using the normal legislation process. I am convinced that if we had worked through the committees of proper ju-

risdiction with the necessary background on the subject matter, not only would we have been able to reach a faster resolution, but probably would have avoided 2 years of rancor and disagreement.

I want to be very clear with the members of the subcommittee. Despite the misinformation being spread by Postal competitors, competition within the mailing market is fierce. Private companies are free to charge different rates for delivery to different addresses or, in the alternative, they may choose to provide no service at all.

In addition to taking on the Postal Service's business internationally, some of our competitors have stepped up their attacks on profitable enterprises such as priority mail, a product on which millions of Americans depend on a daily basis. The revenue generated by such products helps us maintain universal service. At best, the tactics used by these companies refuses to acknowledge this necessity. At worst, they simply don't care. Without this stream of revenue, the Postal Service will not be able to meet with your constituents' demand for service.

Given my years of dealing with the Postal Service and their many issues, I appreciate the difficulty of trying to pass a postal reform bill through the Congress. There are a number of organizations seeking to place their imprint on this bill. Chairman McHugh, you and your staff have been accessible and open-minded in taking on this monumental project.

As you were recently quoted by the Associated Press, "The person who brings the mail is almost a member of the family who visit each and every day." We want to continue that relationship and dedicated service. On behalf of the National Association of Letter Carriers, I'd like to thank you for your tireless efforts to improve the public service provided by the Postal Service. As this bill progresses and continues to take shape, we look forward to working with you.

Mr. MCHUGH. Thank you, Vince, I appreciate your comments. And more to the point, I appreciate you and George Gould, and everybody's efforts to make this a better bill.

[The prepared statement of Mr. Sombrotto follows:]



VINCENT R. SOMBROTTO
PRESIDENT

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Testimony of

VINCENT R. SOMBROTTO, PRESIDENT

Before the

HOUSE GOVERNMENT REFORM

SUBCOMMITTEE ON

THE POSTAL SERVICE

February 11, 1998

CONGRESSIONAL TESTIMONY

**Testimony of
Vincent R. Sombrotto
President of the National Association of Letter Carriers
Before the
House Government Reform
Subcommittee on The Postal Service**

Thank you Chairman McHugh and Members of the Subcommittee for the opportunity to discuss this important piece of legislation. I am Vincent R. Sombrotto, President of the National Association of Letter Carriers, and I am pleased to be here representing the 310,000 members of the NALC.

A recent survey conducted by the Pew Research Center for the People and the Press stated that the public gave the Postal Service an 89% favorability rating, higher than any other federal agency. Another study by ICR of Media, PA said that nearly three fourths of Americans believe the Postal Service is doing an excellent or good job. This is a tribute to the hardworking men and women who make the system work on a daily basis. As the public face of the Postal Service, letter carriers take great pride in receiving such recognition for the outstanding service we provide. While every American has come to rely on these vital services, few understand the way the USPS operates. I can even remember a time, Mr. Chairman, when you yourself acknowledged being surprised by the intricacies involved with timely and efficient mail delivery. You are to be congratulated for dedicating yourself to learning about the Postal Service and taking on this effort to enhance its performance through the introduction of H.R. 22, the "Postal Modernization Act of 1999."

As the Members of the Subcommittee are well aware, the fundamental principle which guides the USPS is universal service at uniform rates. This means that Postal employees must continue to provide normal six-day delivery to all addresses at the same reasonable rate. The public demands nothing less, and the NALC believes that any proposed Postal Reform must fit into that frame-work.

Rather than taking time today to go through the bill section by section, I'd like to focus on a few key points which are critical for meaningful Postal Reform. We are encouraged by some of the changes that have been made in H.R. 22 since its introduction. Chief among those is the elimination of the "Mailbox Demonstration Project" proposed in the original draft of the bill. As you know, the relationship between letter carriers and the public they serve is one of trust and security. Some of our competitors would like nothing more than to destroy that trust, sacrificing a public service in the name of profits. We view the removing of the "Mailbox Demonstration Project" from the bill as an acknowledgment of the desire to maintain the high level of service and professionalism the American people have come to expect from letter carriers.

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Also, I'd like to thank Congressman Fattah for his proposal which would create a labor seat on the Postal Board of Directors as created in HR 22. Since its inception in 1971, 50 individuals have served on the Postal Board of Governors. Members of the business community, former Congressional staff and even dentists have served on the Board, but not one person has come from the ranks of organized labor. Mr. Chairman, there are hundreds of thousands of union employees within the USPS. Sound business practice would dictate that someone serve on the board who understands the challenges facing these hardworking employees. I know there are Members of Congress who have legitimate concerns over reserving specific seats on the Board. At the same time, I thank the Subcommittee for acknowledging the inequity that has existed for all these years.

I am aware that the Postal Service is proposing a number of changes to HR 22. We have recently received some of these proposed measures and are working so that we may fully understand their impact. Given their far reaching scope it would be imprudent for the NALC to express a position on them at this time. We take these proposed changes as well intended, and are eagerly awaiting the reaction of the mailers, other customers and competitors.

While most of the groups paying attention to this bill have the public's best interests at heart, we at the NALC are concerned with some competitors of the Postal Service who are trying -- at all costs -- to break the Postal Service's mandate of universal service. It is imperative that HR 22 not become a vehicle for their self-serving attempts to weaken the Postal Service. Such an effort would undermine the constructive spirit which has characterized the healthy debate surrounding HR 22.

As you are well aware Mr. Chairman, there have been questions raised recently about authority over the Universal Postal Union -- much of which was initiated during the Appropriations process. An apparent compromise was satisfactorily reached. I think it's fair to say all sides gave a little in order to reach that point. My concern is not over a good faith debate about proper policy and objectives. Instead, I would suggest these issues be considered and brought up using the normal legislative process. I am convinced that if we had worked through the committees of proper jurisdiction with the necessary background on the subject-matter, not only would we have been able to reach a faster resolution, but probably would have avoided two years of rancor and disagreement.

I want to be very clear with the Members of the Subcommittee. Despite the misinformation being spread by Postal competitors, competition within the mailing market is fierce. Private companies are free to charge different rates for delivery to different addresses. Or, in the alternative, they may choose to provide no service at all.

In addition to taking on the Postal Service's business internationally, some of our competitors have stepped up their attacks on profitable enterprises such as Priority Mail -- a product on which millions of Americans depend on a daily basis. The revenue generated by such products helps us maintain universal service. At best, the tactics used by these companies refuses to acknowledge this necessity. At worst, they simply don't care. Without this stream of revenue, the Postal Service will not be able meet with the your constituents' demand for service.

Given my years of dealing with the Postal Service and their many issues, I appreciate the difficulty of trying to pass a Postal Reform bill through the Congress. There are a number of organizations seeking to place their imprint on this bill. Chairman McHugh, you and your staff have been accessible and open-minded in taking on this monumental project. As you were recently quoted by the Associated Press "the person who brings the mail is almost a member of the family who visits each and every day." We want to continue that relationship and dedicated service. On behalf of the National Association of Letter Carriers, I'd like to thank you for your tireless efforts to improve public service provided by the Postal Service. As this bill progresses and continues to take shape, we look forward to working with you.

Questions

Panel Four - Postal Labor Unions

Q. What is the connection and or similarity between price caps in the telecommunications industry and price caps in the postal service?

Q. Would you support a streamlined postal reform bill which would only address pricing flexibility and give the postal service the authority to offer new products in a more timely fashion?

Q. Should Congress provide more of a public oversight role to assist the postal in better controlling costs and improve productivity?

Q. Do we need to pass H.R. 22 to effect postal reform or can we work within the existing statute to bring about changes and improvements in postal structure and operations. If so, be more specific.

Q. Currently, postal workers participate in the Federal Employees' Health Benefits Program (FEHBP) and in the Federal Civil Service Retirement program. What happens to postal worker's health and retirement benefits under the Private Law Corporation?

Q. A recent AP poll stated that three-fourths of Americans believe the postal service is doing an excellent or good job. Will the general public, the "Aunt Minnies" of the country support H.R.22? What's in it for them?

The AP poll went on to say that the cost of stamps is too much. Any idea how much Aunt Minnie will pay for postage under H.R. 22?

Q. If we were to enact H.R. 22 today, as currently written, how would postal jobs, services and postage rates be impacted?

Q. How will the postal service address collective bargaining and wage issues under H.R.22? How will collective bargaining be addressed under the Private Law Corporation?

Q. Ted Carrico, President of the National Association of Postmasters of the U.S. expressed a deep concern about the direct appropriation for the PRC. He believes that a connection between Congress and the PRC is dangerous because of the potential for congressional "mis" micro management of the postal service and will serve as a new avenue for postal competitors to cripple the postal service. Your reaction?

Q. Last month the GAO issued a report describing the major performance and management challenges that need to be addressed if the postal service is to sustain performance and remain competitive into the 21st Century.

In what ways can the postal service further reduce costs and what savings can be realized from the ways you have mentioned?

Q. Can we in the Congress provide the postal service greater flexibility to set rates and offer new products quickly, without the establishment of a new price cap rate setting mechanism and the creation of a Private Law Corporation? If not, why not? If so, how?

Q. The postal service is grappling with labor-management issues, the challenges on containing costs, the need to better protect revenues, the

need to implement reliable indicators of postal performance and risks from Y2K computer problems. Can we expect the postal service to address all these very serious matters and be subject to the type of postal reform envisioned in H.R.22?



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TESTIMONY OF
VINCENT R. SOMBROTTO, PRESIDENT
NATIONAL ASSOCIATION OF LETTER CARRIERS

IN RESPONSE TO QUESTIONS FROM
THE HOUSE SUBCOMMITTEE ON THE POSTAL SERVICE

April 15, 1999

CONGRESSIONAL TESTIMONY

**Testimony of
Vincent R. Sombrotto, President
National Association of Letter Carriers
in Response to Questions from
House Subcommittee on the Postal Service**

1. The similarities between the telecom and postal industries are limited. Though both are "network" industries, the telecom industry is capital intensive and is in the process of a technological revolution. The postal sector, on the other hand, is labor intensive and involves more mature technologies. Thus, while one can expect higher than average productivity growth in the telecom sector, the productivity gains to be achieved in the postal sector are more likely to be near the average growth in the overall economy. This crucial difference should be reflected in the structure of any price cap system.

Since the CPI embodies average productivity growth in the economy, a simple price cap based on the CPI with no adjustment factor may be appropriate for the Postal Service while an adjustment factor might be more appropriate for the telecom sector. If there is an adjustment factor for a postal price cap regime, it should be "hard-wired" if possible: For example, the adjustment factor X in a "CPI minus X" price cap might be defined as the difference between USPS Total Factor Productivity and Multi-Factor Productivity in the nonfarm business sector of the economy.
2. The NALC supports efforts to give the Postal Service increased pricing and product flexibility. This would enhance the choices available to both individual and corporate customers in the marketplace. We believe that this is generally advantageous not only to postal employees, but to the American public as a whole.
3. The NALC believes that the current level of Congressional oversight of the USPS is appropriate. As the representative of 240,000 active letter carriers, I would have grave concerns about the implications that increased oversight would have on the collective bargaining process. In addition, while Chairman McHugh has a keen understanding of the Postal Service and its operations, it would may be unreasonable to expect too many Members of Congress to have the necessary background and understanding or time to exercise effective oversight of the USPS.
4. The strength of H.R. 22 is that it is a comprehensive package. As we have seen in recent years, piece-meal reform going around the committee of proper jurisdiction and background — specifically, using the appropriations process for change — creates more chaos than sound decision-making.

5. In order for postal reform to work for postal employees, we must preserve the sanctity of the collective bargaining process — whether the employees are part of the USPS as we currently know it or a private law corporation. If there is a private law company, the reform bill should permit workers employed by it to opt into participation in FEHBP, FERS and other federal benefit programs — subject, of course, to the collective bargaining process. However, in such a corporation, employees — through their unions — should be free to negotiate alternative benefit programs, as is the current law.
6. The support of the "Aunt Minnies" rests on whether the Postal Service can continue to provide the service they have come to expect at affordable prices. USPS needs the opportunity to offer new services and replace revenues lost to electronic diversion with new revenues from new services. Absent these new services, the ability of the Postal Service to deliver universal service at affordable rates may be challenged. This would be unacceptable, not only to Aunt Minnie, but also to commercial customers and to the employees of the postal service that bring them their mail.
7. Given the number of variables involved, it is impossible to predict the impact H.R. 22 would have on postal jobs, services and postage rates. It may be that the increased commercial freedoms and pricing flexibility will enable the USPS to enhance service which would both hold down rates and possibly create more jobs. However, if the price cap is too restrictive (i.e., if the PRC adopts too onerous an adjustment factor) rates could be held down, but the level of service might be reduced and jobs might have to be cut.
8. At this time, it would not be appropriate to comment on how the USPS would address collective bargaining issues. We appreciate Congressman Gilman's efforts to ensure that the PRC not interfere with collective bargaining, and further hope that the current language can be strengthened to give it the full weight of law.

The NALC would expect the same collective bargaining rights for workers employed by the private law corporation that they presently enjoy with the USPS.
9. This question again emphasizes how important it is that any postal reform happen through the appropriate committee and not through the appropriations process. In addition, as we have seen in the recent past, the absence of such an appropriation has not precluded such attempts at micro-management by some Members of Congress.
10. An entity of the size and scope of the postal service cannot expect to reduce costs without engaging in partnerships with labor organizations. Any increased productivity in such a labor intensive business necessarily requires the cooperation of front-line workers. Therefore, the NALC would respectfully

request that such attempts at increasing performance be addressed at the bargaining table.

11. The existing rate setting process has effectively resulted in a cap on rates. Since reorganization, rates have generally gone up with the Consumer Price Index. We also believe that allowing volume discounts and negotiated service agreements would place downward pressure on rates through increased revenue.
12. It seems that this is a question that the Postal Service is in the best position to answer. However, given the number of proposed amendments to H.R. 22 that they have submitted, they do not appear to be concerned about simultaneously dealing with postal reform and the other challenges they currently face.

Mr. McHUGH. With that, we will now turn to President Quinn, the president of the National Postal Mail Handlers Union. Welcome, sir, good to see you again. We look forward to your comments.

Mr. QUINN. Good to see you, Mr. Chairman. Thank you again, and to the distinguished members of the subcommittee, I'm Billy Quinn. I'm the national president of the National Postal Mail Handlers Union. On behalf of the more than 50,000 mail handler union members employed by the Postal Service, I appreciate the opportunity to testify about postal reform and H.R. 22, the Postal Modernization Act of 1999.

Our approach to postal reform is relatively simple because it is motivated by two fundamental principles. First, as we stated in our joint statement with the letter carrier unions last year, if it is to be enacted at all, postal reform must maintain and indeed enhance the operations of the Postal Service.

By this we mean that the key ingredient to any type of postal legislation is to protect the ability of the Postal Service to provide universal service to the mailing public. Postal employees must continue to process and deliver letters and packages to every one, every where, every day. This universal service has to be maintained at affordable rates, but these rates must be sufficient to protect and support the infrastructure that universal service requires and to provide postal employees with a decent and fair standard of living. We understand that this subcommittee agrees with the fundamental goal of universal service, and we commend your painstaking efforts to ensure that any reform legislation furthers this goal.

Second, and equally fundamental, we also strongly believe that Congress should not impede upon the often complex relationship between the Postal Service and its employees. This relationship, though at times difficult if not contentious, is best carried out within the framework of collective bargaining. The collective bargaining process should be treated as sacred, and should not be adversely affected either intentionally or inadvertently by enactment of postal reform.

Indeed, as you may know, the Postal Service and the National Postal Mail Handlers Union just recently signed a new 2 year collective bargaining agreement, demonstrating once again that face-to-face negotiations can and should be the means for resolving labor disputes.

In simple terms, this means that any reform legislation should not allow or encourage interference in Postal labor relationships, either directly from Congress through the statute itself, or less directly through the Postal Rate Commission, or the Postal Regulatory Commission, or some other legislatively imposed party.

On another more complex level, this means that the collective bargaining process must be allowed to function without artificially imposed constraints such as price caps that effectively become wage caps. The bargaining process must be allowed to set wages and benefits. And the Postal Service must realize it needs to pay for its labor costs through appropriate postal rates. These two fundamental principles dictate our approach to postal reform.

We therefore support legislative efforts to truncate the overly cumbersome ratemaking process and generally support the pricing flexibility sought by the Postal Service. With equal vigor we oppose any legislative reform that effectively would limit that pricing flexibility with an unfair and unreasonable cap on rates. If fair and decent wages require an increase in postal rates, then the Postal Service must be allowed to raise its rates without jumping through the overly cumbersome hoops that exist under the current PRA.

Two additional points deserve mention. First, the NPMHU generally supports the amendments adopted by the subcommittee last September, especially those that would add a labor representative to the Board of Governors, provide re-employment assistance if any Postal workers are displaced by automation or privatization, and to prevent any reform legislation from adversely affecting employee or union rights.

Finally, I would be remiss if on the record I did not alert the subcommittee to a lurking danger that is known by everyone in this room, but that few are willing to acknowledge openly. Namely that the driving force behind particular provisions of H.R. 22 should be the public interest and not the interests of certain large profit-driven corporations such as Federal Express or the United Parcel Service.

For more than 200 years the Postal Service and its employees have served the Nation by ensuring universal service of postal communications at reasonable rates. Postal reform that puts the Postal Service or its employees at risk does not serve the public interest, but rather will be remembered only as legislation that destroys one of the unique aspects of the American experience.

Thus, the primary factor in your consideration of H.R. 22, during the coming weeks and months, must be the interests of the public in maintaining the strength and viability of Postal Service and its 800,000 employees. I dare say, even if others are hesitant to say so publicly, that Federal Express or FedEx, UPS, and other competitors of the Postal Service are motivated by other factors.

I know the members of this subcommittee recognize this reality. We look forward to continuing to work with the subcommittee and its staff during the next few months to ensure that H.R. 22, if reported out of committee, is legislation that the NPMHU can support. Thank you for the chance to testify today. I would be happy to answer any questions that you may have.

Mr. MCHUGH. Thank you very much, Billy, I appreciate it. And to you, as well, thanks on behalf of all the subcommittee for your efforts and untiring work to try to have this bill better reflect the interests of your members.

[The prepared statement of Mr. Quinn follows:]



National Postal Mail Handlers Union

William H. Quinn
National President

Mark A. Gardner
Secretary-Treasurer

Hardy Williams
*Vice President
Central Region*

Samuel C. D'Ambrosio
*Vice President
Eastern Region*

John F. Hegarty
*Vice President
Northwestern Region*

James C. Terrell
*Vice President
Southern Region*

Lou Kuchenriter
*Vice President
Western Region*

TESTIMONY OF

**WILLIAM H. QUINN
NATIONAL PRESIDENT**

**NATIONAL POSTAL
MAIL HANDLERS UNION**

BEFORE THE

**SUBCOMMITTEE ON
THE POSTAL SERVICE**

**H.R. 22
POSTAL MODERNIZATION ACT OF 1999**

FEBRUARY 11, 1999

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TESTIMONY OF

WILLIAM H. QUINN

NATIONAL PRESIDENT

NATIONAL POSTAL MAIL HANDLERS UNION

BEFORE THE

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H.R. 22

POSTAL MODERNIZATION ACT OF 1999

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requires and to provide postal employees with a decent and fair standard of living. We understand that this Subcommittee agrees with the fundamental goal of universal service, and we commend your painstaking efforts to ensure that any reform legislation furthers this goal.

Second, and equally fundamental, we also strongly believe that Congress should not impede upon the often complex relationship between the Postal Service and its employees. This relationship, though at times difficult if not contentious, is best carried out within the framework of collective bargaining. The collective bargaining process should be treated as sacred, and should not be adversely affected, either intentionally or inadvertently, by enactment of postal reform. Indeed, as you may know, the Postal Service and the National Postal Mail Handlers Union just recently signed a new, two-year collective bargaining agreement, demonstrating once again that face-to-face negotiations can and should be the means for resolving labor disputes.

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We look forward to continuing to work with the Subcommittee and its staff during the next few months to ensure that H.R. 22, if reported out of committee, is legislation that the NPMHU can support.

Thank you for the chance to testify today. I would be happy to answer any questions you may have.

Mr. MCHUGH. Last, certainly not least, the president of the National Rural Letter Carriers Association, Steve Smith. Mr. President, good to see you. Thanks for being with us. And the floor is yours, sir.

Mr. SMITH. Thank you, sir, and thank you for the opportunity. Good afternoon, Mr. Chairman and members of the committee. I am Steve Smith, president of the 97,000 member National Rural Letter Carriers Association. Most rural carriers drive their own vehicles while serving as a post office on wheels. Daily, we travel more than 3 million miles to 27.4 million delivery points on some 63,000 rural routes across the United States.

Chairman McHugh, in response to changing competition, expanding alternatives to the Postal Service, and postal officials' requests, you began to examine the regulatory framework imposed by that legislation. You conducted comprehensive hearings, you held endless private meetings with all organized groups concerned and affected by reform legislation. You even utilized the Internet.

You and your staff have crafted a comprehensive proposal for change in the Postal universe. In the process of arriving at a proposal, you have been thoughtful, open and creative. This is why the NRLCA will remain supportive of your efforts to enact comprehensive reform capable of carrying the Postal Service into the 21st century. We remain cautiously optimistic pending proposed amendments and the natural ebbs and flows of the legislative process in both chambers and conference committee.

We hope our competitors learn the U.S. Postal Service is not the principle reason for their market share decline. The Postal Service did not cause the UPS strike, or business loss in Europe as the result of European postal competition, referring to the Wall Street Journal article on January 18, 1999.

The Postal Service has merely 6 percent of the parcel post business. Our competitors further cite the proposition that USPS does not pay for tags nor taxes on vehicles. When this accusation is made, they omit the fact that most rural carriers use their own vehicles to deliver the mail. Rural carriers certainly do buy tags and pay all appropriate State and local taxes on their vehicles.

NRLCA has always remained somewhat skeptical of the separate accounting concept for the competitive products. We simply do not see how dividing the competitive and non-competitive products for accounting purposes is done easily; 54 percent of rural letter carriers work out of post offices with one or two rural routes; 82 percent of rural letter carriers work out of one to five route post offices. Every day we carry both types of mail in varying volumes. In those offices there is no alternative to rural carriers delivering all types of mail. How can one accomplish separate accounting of personnel and vehicles.

The proposed legislation would allow the USPS to form a private law corporation for non-postal products and engage in strategic alliances in or with private companies. The Postal Service has enhanced your concept with its proposed amendments by suggesting this corporation should issue stock. However, once stockholders are involved, the obligation of the company would shift to satisfying the shareholders. NRLCA believes that those shareholders wouldn't be

very interested in sharing profits with the competitive and monopoly side of the ledger.

Additionally, let us look at a few examples of USPS attempts at non-traditional business products such as caps, mugs, ties, t-shirts, auto flyers and mailing on-line. Each enterprise prompted small business owners to appeal to their congressional Representatives to stop the Postal Service from selling these goods. NRLCA suspects that even after postal reform there will be continuing congressional oversight of the USPS.

In the final analysis, the public and its elected representatives are going to demand that the U.S. Postal Service stick to the basic public policy mandate of serving the public by collecting and delivering mail every where, to every one, every day. Mr. Chairman, and members of the committee, thank you.

[The prepared statement of Mr. Smith follows:]



NATIONAL RURAL LETTER CARRIERS' ASSOCIATION

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TESTIMONY

OF

STEVEN R. SMITH, PRESIDENT

NATIONAL RURAL LETTER CARRIERS' ASSOCIATION

BEFORE THE

POSTAL SERVICE SUBCOMMITTEE

HOUSE GOVERNMENT REFORM COMMITTEE

ON

HR 22 -- POSTAL REFORM

FEBRUARY 11, 1999

Good Afternoon Mr. Chairman and Members of the Committee. I am Steve Smith President of the 97,000 member National Rural Letter Carriers' Association. Most rural letter carriers drive their own vehicles while serving as a post office on wheels. Daily, we travel more than 3 million miles to 27.4 million delivery points on 63,000 rural routes across the United States.

Background

In the late 1960's the old Post Office Department was in crisis, huge amounts of mail weren't being delivered. Action by Presidents of two different political parties resulted in the Postal Reorganization Act of 1971 and for 25 years the PRA framework has served the mailing public, mailers and the country well.

Chairman McHugh, in response to changing competition, expanding alternatives to the Postal Service, and postal officials' requests, you began to examine the regulatory framework imposed by that legislation. You conducted comprehensive hearings. You held endless private meetings with all organized groups concerned and affected by reform legislation. You even utilized the Internet. You and your staff have crafted a comprehensive proposal for change in the postal universe. In the process of arriving at a proposal you have been thoughtful, open and creative. That is why the NRLCA will remain supportive of your efforts to enact comprehensive reform capable of carrying the Postal Service into the 21st century. We remain cautiously optimistic, pending proposed amendments, and the natural ebbs and flows of the legislative process in both chambers and conference committee.

The Postal Service is the only delivery organization whose mission is to go to everyone, everywhere, everyday. USPS currently has an obligation to provide universal service at uniform prices. That is our public service obligation. It is a fact. It is not refutable. What is being questioned is whether the Postal Service uses money from the monopoly to subsidize competitive or non-postal products. We strongly believe it does not.

Our Competitors

NRLCA would like to make several suggestions to our competitors. When a compromise is made, stick to it. All parties agreed to the legislative language affecting representation at the Universal Postal Union. It was a shame that an issue of bureau placement within the State Department had to be elevated to the level of the Office of Secretary of State.

We hope our competitors learn the US Postal Service is not the principal reason for their market share decline. The Postal Service did not cause the UPS strike or business lost in Europe as a result of European postal competition, referring to the Wall Street Journal article on January 18, 1999. The Postal Service has merely 6% of the parcel post business.

Our competitors further cite the proposition that USPS does not pay for tags or taxes on vehicles. When this accusation is made, they omit the fact that most rural letter carriers use their own vehicles to deliver the mail. Rural carriers certainly do buy tags and pay all appropriate state and local taxes on their vehicles.

Firewall Accounting

NRLCA has always remained somewhat skeptical of the separate accounting concept for the competitive products. We simply do not see how dividing the competitive and non-competitive products for accounting purposes is done easily. 54% of rural letter carriers work out of Post Offices with one or two rural routes. 82% of rural letter carriers work out of 1 to 5 route post offices. Every day we carry both types of mail in varying volumes. In those offices there is no alternative to rural carriers delivering all types of mail. How can one accomplish separate accounting of personnel and vehicles?

Private Law Corporation

The proposed legislation would allow the USPS to form a private law corporation for non-postal products and engage in strategic alliances in or with private companies. The Postal Service has enhanced your concept with its proposed amendments by suggesting this corporation could issue stock. However, once stockholders are involved, the obligation of the company would shift to satisfying those shareholders. NRLCA believes that those shareholders wouldn't be very interested in sharing profits with the competitive and monopoly side of the ledger.

Additionally, let us look at a few examples of USPS attempts at non-traditional business products such as caps, mugs, ties, t-shirts, auto fliers, and mailing online. Each enterprise prompted small business owners to appeal to their congressional representatives to stop the Postal Service from selling these goods. NRLCA suspects that even after postal reform, there will be continuing congressional oversight of the USPS.

In the final analysis, the public and its elected representatives are going to demand that the USPS stick to the basic public policy mandate of serving the public by collecting and delivering mail everywhere, to everyone, everyday.

Mr. Chairman and Members of the Committee, thank you.

Mr. MCHUGH. Thank you, President Smith. And to you and your membership a great appreciation for your very constructive and positive role. As with the management associations it's obviously very clear to me and everyone on this subcommittee, that all of you bring a very fierce loyalty for your membership. That's not just understandable, it's the right thing. Your members are collectively very, very well served.

As you know, President Sombrotto, and Smith, and Quinn, you chose to stay involved and be at the table, and I thank you for that. President Biller chose a different tact. I wished he hadn't. Not so much that it would have helped or hurt him personally, but rather I think their presence at the table would have been enormously beneficial to us and to our work product.

However, even at that, as President Biller said, Moe said in his opening comments, we are very well aware of the concerns and the objections to the bill that you have. So you have certainly represented your membership well in that regard, as well. There probably is no other part of this process that has been amended more times than that with respect to employee relations.

In spite of the pledge that I took very early on in this process, that we were not intending in this bill to in any way negotiate or to settle any of the management-labor differences, we have still time and time again tried to respond to the very legitimate concerns that in the main you people brought to us.

President Quinn mentioned the amendments that the ranking member and others through the last mark-up brought with respect to adding a member of labor to the Board of Governors, with respect to doing legislative language that would try to ensure that whatever happens does not have an adverse impact on the Postal employees.

We, as well, have tried to build in H.R. 22 a number of changes that Vince Sombrotto and others have mentioned with respect to eliminating the mailbox test because of the concerns that you expressed.

We have put in language that very clearly, I think, says that, No. 1, the Postal Rate Commission has no authority, no role in the collective bargaining process, that none of its deliberations can or should have any impact on that process. And, No. 2, to provide a very specific provision in the bill to ensure that the PRC can actually grant to the Postal Service additional pass-throughs above CPI, where there are the kinds of expenses beyond the cap that a union contract might indeed produce. So those are the kinds of things, the issues that you brought to us, and we tried to address those. As President Smith said, we expect that process will continue. We look forward to your additional comments and input. I'd invite Moe Biller back to at least talk to us, as that process goes forward. The door is open at any time in that regard.

But let me just make a couple of comments about wages, and about union contracts and collective bargaining, because it is important. The economist that President Biller's union has engaged, Dr. Popkin, has presented testimony to the subcommittee on this issue. It's been reflected in a variety of ways since then. And I don't want to repeat myself.

But, again, if we can go back to the specific language that talks about how nothing in the rate caps is intended in any way to affect the collective bargaining process, that, again, there is a direct provision for an additional pass-through on rates above CPI where the union contracts do become an added cost driver, I think it's important to point out a couple of things, and this point has been raised by some of you at the table as a source of pride, and understandably.

The fact of the matter is, when we close the text books on the economic discussions and theory, as interesting as they are, the experience of Postal employees is clear and it's undeniable. Your wages have not kept pace with CPI. So even if CPI and the wage cap were a hard ceiling, which I again argue they are not, but even if they were, had your contracts reflected CPI, your members would be earning more money than they are right now, No. 1.

No. 2, as you know, one of the things we wanted most to change was to institute a bonus system that brings the people into the benefit package that, in my opinion, do the lion's share of the work, your members. Right now it's basically management levels that share the bonus.

We did a calculation that shows that had the bonus provisions of H.R. 22 been in force over just the past 4 years, the average employee, and many obviously are above average, but the average employee would have received nearly \$1,700, would have received \$1,689 in each 1 of those past 4 years. That would have meant \$6,800 more in pocket to your members, each and every member, had this bill been in place.

The point is we made every effort, it seems to me, to try to ensure that employees are not harmed by this, that, indeed, they are helped by this. Because, as Moe Biller said, this is a highly labor intensive organization. When you have 800,000 or 750, depending on whose figures you use, over 700,000 hard working Americans in an organization that really is equatable to about 80 percent of the operating costs, you've got to pay attention to them if you are going to do anything remotely positive. And we've always tried to keep that in mind.

So at the end of the day, we want to ensure that this is good for your members, it is good for Postal employees. And I'm not troubled by that. I'm not worried about anybody labeling me as a lackey of this group or a lap dog of that one, because the Postal Service that I know is successful for one reason, because of those people who go out and make it work in the Pierrepont Manors, and in the Philadelphias, and in every town, hamlet, village, and city of this Nation. So I wanted to put that on the record to reassure you, if nothing else, of our intent.

I, frankly, don't have any questions for you gentlemen. And that's for one reason. We have been with you at the table and exchanging information and I don't think we have any areas of misunderstanding or in need of clarification, No. 1. And, No. 2, I feel very confident we are going to continue to work together. Now what that means is at the end of the day it will be your judgment to make. And I'd like to try to persuade you but I'm not going to try to do that. You are far too loyal on behalf of your members to

have that kind of effort succeed any way. So we're really looking forward to that continuing.

And in reading your testimony, by and large, it confirmed the relatively positive feeling in that regard that I have. So I could sit here and throw a few out for the record, if it would make everybody happy. But, by and large, I think we need to continue to do what we have been doing. At the end of it, hopefully we will have done some good. So that's my speech. Has anybody got one back at me? President Smith.

Mr. SMITH. I would like to thank you for the opportunity to come to you, as you gave us the opportunity, to address those issues that we were concerned with. And you gave us that opportunity.

I was struck by your remarks a moment ago about all of us being fiercely loyal to our members, but you know we and our members are fiercely loyal to the Postal Service. We want the Postal Service to succeed. And all of us want whatever comes out of this bill to be good for the Postal Service because it in turn is good for us. Thank you for the opportunity to participate.

Mr. MCHUGH. Thank you. And, by the way, you should always as a politician remember you are never sure how your words are going to be interpreted. I meant "fiercely loyal" as a compliment. I hope you took it that way?

Mr. SMITH. Yes.

[Additional questions for Mr. Smith follow:]

PANEL FOUR - POSTAL LABOR UNIONS

- Q. What is the connection and/or similarity between price caps in the telecommunications industry and price caps in the Postal Service?
 - a. I don't know.

- Q. Would you support a streamlined postal reform bill which would only address pricing flexibility and give the Postal Service the authority to offer new products in a more timely fashion?
 - a. I would have to read it.

- Q. Should Congress provide more of a public oversight role to assist the Postal Service in better controlling costs and improve productivity?
 - a. The current oversight is fine.

- Q. Do we need to pass H.R. 22 to effect postal reform or can we work within the existing statute to bring about changes and improvements in postal structure and operations. If so, be more specific.
 - a. Current law reforms are possible, but the USPS and PRC would be forced to cooperate more.

- Q. Currently, postal workers participate in the Federal Employees' Health Benefits Program (FEHBP) and in the Federal Civil Service Retirement program. What happens to postal workers' health and retirement benefits under the Private Law Corporation?
 - a. We presume the same.

- Q. A recent AP poll stated that three-fourths of Americans believe the Postal Service is doing an excellent or good job. Will the general public, the "Aunt Minnies" of the country support H.R. 22? What's in it for them?
 - a. Continued on-time delivery.

- Q. The AP poll went on to say that the cost of stamps is too much. Any idea how much "Aunt Minnie" will pay for postage under H.R. 22?
- a. No.
- Q. If we were to enact H.R. 22 today, as currently written, how would postal jobs, services and postage rates be impacted?
- a. Hopefully, the changes would insure the ability to go into the 21st Century as a viable entity.
- Q. How will the Postal Service address collective bargaining and wage issues under H.R. 22? How will collective bargaining be addressed under the Private Law Corporation?
- a. The same as they do now.
- Q. Ted Carrico, President of the National Association of Postmasters of the United States, expressed a deep concern about the direct appropriation for the PRC. He believes that a connection between Congress and the PRC is dangerous because of the potential for congressional "mis" micro management of the Postal Service and will serve as a new avenue for postal competitors to cripple the Postal Service. Your reaction?
- a. A direct appropriation is a poor idea.
- Q. Last month, the GAO issued a report describing the major performance and management challenges that need to be addressed if the Postal Service is to sustain performance and remain competitive into the 21st Century.

In what ways can the Postal Service further reduce costs and what savings can be realized from the ways you have mentioned?
- a. Collectively work smarter.
- Q. Can we, in the Congress, provide the Postal Service greater flexibility to set rates and offer new products quickly, without the establishment of a new price cap rate setting mechanism and the creation of a Private Law Corporation? If not, why not? If so, how?
- a. Probably. Ask CRS for options.

- Q. The Postal Service is grappling with labor-management issues, the challenges on containing costs, the need to better protect revenues, the need to implement reliable indicators of postal performance and risks from Y2K computer problems. Can we expect the Postal Service to address all these very serious matters and be subject to the type of postal reform envisioned in H.R. 22?
- a. Yes.

Mr. MCHUGH. Well, with that, gentlemen, thank you again. I look forward to working with you. Let me thank everyone in the room here today for your incredible patience, perhaps your lack of sanity, but your incredible patience. This has been as open a process as we have been able to maintain. We are going to continue to try to do that. You know the staff, and we look forward to working with you.

We have a Y2K hearing on February 23rd, if you are really looking for some excitement. But the next hearing on this issue will be conducted March 4th. I don't know if it will be in this room. After my treatment of him this morning, the chairman will probably never let me back in here. But we'll let you know where, and we hope you'll share some time with us then. And with that, the hearing is adjourned.

[Whereupon, at 2:25 p.m., the subcommittee was adjourned.]

[Additional information submitted for the hearing record follows:]

Written Statement Submitted by

The Department of State

on H.R. 22, The Postal Modernization Act of 1999

Subcommittee on the Postal Service
Committee on Government Reform and Oversight
House of Representatives

February 11, 1999

The Department of State welcomes its new role in overseeing international postal policy concerning the Universal Postal Union (UPU). We take very seriously our new responsibility to ensure that the views of private providers, postal users, the general public, and other agencies are taken into account as we form U.S. positions for the UPU.

The Department of State is committed to a fair and open process. We have many good models to follow and much experience in managing policy formulation for multilateral organizations and UN technical agencies such as the Universal Postal Union. We have had a number of discussions with the private sector and other government agencies to develop a process for working with UPU "stake holders". We have looked at several ways to synthesize industry, consumer, and government interests concerning complex issues in multilateral organizations, including USTR's Industry Sector Advisory Committees (ISAC's) and the International Maritime Organization and World Health Organization processes led by State.

It appears that UPU stake holders are not wedded to one particular model at this time, but would like to see an open and transparent process in which its views are seriously considered as the United States formulates international postal policies and policies toward specific UPU proposals. Postal consumers, private operators and other UPU stake holders also recognize that in this transition period it is important to hear their views, however informally, and incorporate them in U.S. positions in preparation for the August 1999 Beijing Postal Congress.

As an initial step in this open, transparent process, the Department held its first formal public meeting on US policies in the UPU on January 26. We expect to receive written follow-up which will be publicly available and used in forming our government's positions.

We plan to hold a series of similar meetings before the Beijing Postal Congress which will allow us to brief all interested parties on the state of play vis-à-vis the various issues in the UPU about which they have voiced concerns or that potentially affect industry or consumers. During these meetings, to which representatives from all interested government agencies will also be invited, we will be open to private sector comments and observations, and will accept written comments from all parties at any time, which we expect to make publicly available. We will consider all views gathered in formulating U.S. positions

for the Beijing Congress and other meetings in the Universal Postal Union. It is also our intention to make public the positions we will take on issues of concern to the private sector. If adjustments to the process outlined above are called for to achieve our objectives, we will consider changes that make sense as we tailor our efforts to meet stake holder needs.

Since the Beijing Postal Congress is only months away, we must move quickly to integrate all U.S. views in the international postal policy process. The Bureau of International Organization Affairs' Office of Technical and Specialized Agencies (IO/T) manages this process within the Department of State.

We look forward to working with the Congress, U.S. postal consumers, private operators and other interested parties as we consider how to give each sector a level playing field in US policy toward the UPU.

H.R. 22, THE POSTAL MODERNIZATION ACT OF 1999

THURSDAY, MARCH 4, 1999

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON THE POSTAL SERVICE,
COMMITTEE ON GOVERNMENT REFORM,
Washington, DC.

The subcommittee met, pursuant to notice, at 1:07 p.m., in room 2154, Rayburn House Office Building, Hon. John M. McHugh (chairman of the subcommittee) presiding.

Present: Representatives McHugh, Sanford, LaTourette, Burton, Owens, and Davis.

Staff present: Jane Hatcherson, legislative assistant; Abigail D. Hurowitz, clerk; Tom Sharkey; Robert Taub, staff director; Heea Vazirani-Fales, counsel; Denise Wilson, minority professional staff member; and Jean Gosa, minority staff assistant.

Mr. MCHUGH. Let me call the meeting to order. Good afternoon. I want to welcome you all to what is the third hearing for the Postal Subcommittee in this Congress. Three weeks ago, as many of you heard and witnessed, we received testimony from the Postal Service, the Rate Commission, and the postal employee groups on the current version of H.R. 22, as reported by the subcommittee last fall.

Our 4-year journey continues today as we hear from Cabinet departments, it says—I guess it should read Cabinet department and I will say a little bit about that in a moment—and a variety of competitors and customers of the Postal Service, both live and for the record.

Such a hearing, I feel, is consistent with our longstanding approach of attempting to ensure that we obtain as many points of view on this legislation as practical. As in the past, I look forward to yet another full and frank exchange with all four panels, or three-and-a-half panels, as the case may be.

As I have tried to consistently maintain, the goal of H.R. 22 has been and remains twofold: to provide the Postal Service greater freedom to compete, both today and into tomorrow, in order to successfully carry out its universal service mission, while at the same time establishing new rules to ensure fair competition and protect the public interest.

We will hear today from some who suggest that the best alternative is to generally keep the status quo and restrict the Postal Service to its noncompetitive products, leaving it unresponsive, as demand for those services continues to decline.

Of course, many of these same groups also demand the Postal Service somehow provide lower rates and better service. Given such statements, I believe it is important to underscore that, because of H.R. 22's price caps, strong oversight, and overall incentives for greater competitiveness and efficiency, this bill would almost surely result in lower rates and better Postal Service for noncompetitive customers compared to what rates and service will be if H.R. 22 is not, in my opinion, ultimately enacted.

H.R. 22, I believe, strengthens consumer protections through such provisions, among others, as quality of service reviews, complaint processes with much greater enforcement power, subpoena power, and annual audits.

Let us take price caps as one example. Rather than being a totally untested and unknown process, as a few of the testimonies submitted today imply, in reality, eight foreign nations presently use price-cap plans to regulate their post office's rates. So it is not some blind journey into the unknown.

While price caps would provide the Postal Service new pricing freedom, they would also rectify a problem with the 1970 act. Currently, the Service has sole discretion to determine the overall level of revenues to be extracted from captive customers and, as such, has little reason to control costs.

Clearly, an independently administered system of price caps would represent a vast improvement in protecting the public interest. Some mailers apparently feel that they are riding a winning trend with respect to their particular rates, as determined in the last few rate cases, and, therefore, assume that this trend will continue, in their minds, forever. However, I would suggest we don't have the luxury of enjoying the future until it has, in fact, become the past. When you have a system, as we do, that is without constraint and at a meaningful measure as to the overall level of revenues that the Postal Service can demand in a rate case, then no one should feel secure about their likely position come tomorrow.

Perhaps a few of those folks who somehow feel warm and fuzzy about their future rate trends and protections under the existing framework might wish to speak to the nonprofit mailers testifying today who would, I think, provide a somewhat different perspective.

While this may be the last of 4 years of subcommittee hearings on H.R. 22, the last subcommittee hearing on H.R. 22—[laughter.]

We are at step 1 of the legislative process, and there still is a long way to go. At the conclusion of today's hearing, as we have since the beginning, we will fully digest all of the comments received and, where we can, modify the bill to respond to those constructive concerns and suggestions that have been put forward, and there are many.

I would be remiss if I did not note a special coincidence today. In fact, at this moment, there is a memorial service being held on the House floor for a legendary and well-respected Member of the House, Mo Udall. As many know, Congressman Udall was one of the key forces in making the Postal Reorganization Act a reality back in 1970. Indeed, as just one example of how far that Postal Service has come from its challenges in those old days, some of us may be able to recall Mr. Udall's joking remedy for the inflation

this Nation was dealing with in 1972, when he said, "Let's turn inflation over to the post office. That will slow it down." [Laughter.]

I know our dear, departed friend would be pleased to know that through the work he helped to begin, and especially because of the hardworking postal workers, that joke no longer works. Times have certainly changed, and the postal system he helped create has served this Nation so very well for more than a generation. As we continue the journey of modernizing our Nation's postal laws, I know that we will succeed if we infuse our efforts with the vision and the bipartisanship that Congressman Udall and his colleagues brought to the table nearly 30 years ago.

So, with that, again, I welcome you all. I would be happy to yield to my friend on my right, Danny Davis, the acting ranking member, for any comments he may wish to make.

[The prepared statement of Hon. John M. McHugh follows:]



U.S. HOUSE OF REPRESENTATIVES • WASHINGTON, D.C 20515 • 202-225-4611

Statement of the Honorable John M. McHugh, Chairman
Subcommittee on the Postal Service
HR 22 Hearing - March 4, 1999

Good Afternoon. The Subcommittee's third hearing in the 106th Congress will come to order. I welcome all of my colleagues.

Three weeks ago, we heard from the Postal Service, the Rate Commission, and the postal employee groups on the current version of HR 22, as passed by the Subcommittee last fall. Our four-year journey continues today as we hear from cabinet departments and a variety of competitors and customers of the Postal Service, both "live" and "for the record." Such a hearing is consistent with our longstanding approach of attempting to ensure that we obtain as many points of view on the legislation as practical. I look forward to yet another full, frank, and fair exchange with all four of today's panels.

As I have consistently maintained, the goal of HR 22 is two-fold: to provide the Postal Service greater freedom to compete, both today and into tomorrow, in order to successfully carry out its universal service mission, while at the same time, establishing new rules to ensure fair competition and protect the public interest. We will hear today from some who suggest that the best alternative is to generally keep the status quo and restrict the Postal Service to its noncompetitive products, leaving it unresponsive as demand for those services continues to decline. Of course, many of these same groups also demand the Postal Service somehow provide lower rates and better service.

Given such statements, I believe it's important to underscore that because of HR 22's price caps, strong oversight, and overall incentives for greater competitiveness and efficiency, this bill would almost surely result in lower rates and better postal service for noncompetitive customers compared to what rates and service will be if HR 22 is not ultimately enacted. HR 22 strengthens consumer protections through such provisions - among others - as quality-of-service reviews, complaint processes with much greater enforcement power, subpoena power, and annual audits.

Let's take price caps as one example. Rather than being a totally untested and unknown process, as a few of the testimonies submitted today imply, in reality, eight foreign nations presently use price cap plans to regulate their post offices' rates. So it's not some blind journey into the unknown. While price caps would provide the Postal Service new pricing freedom, they would also rectify a problem with the 1970 Act. Currently, the Service has sole discretion to determine the overall level of revenues to be extracted from captive customers, and as such, has little reason to control costs. Clearly, an independently administered system of price caps would represent a vast improvement in protecting the public interest.

Some mailers apparently feel that they are riding a winning trend with respect to their particular rates as determined in the last couple of rate cases and, therefore, assume that this particular trend line will continue. However, I would suggest we don't have the luxury of enjoying the future until that future has actually become the past. When you have a system that is without constraint in any meaningful measure as to the overall level of revenues that the Postal Service can demand in a rate case, then no one should feel secure about their likely position tomorrow. Perhaps a few of those folks who are all warm and fuzzy about their future rate trends and protections under the existing framework might wish to speak with the nonprofit mailers testifying today who provide a somewhat different perspective.

While this may be the last of four years of Subcommittee hearings on HR 22, we are at step one of the legislative process and there is still a long way to go. At the conclusion of today's hearing, as we have since the beginning, we will fully digest all of the comments received, and modify the bill to respond to those constructive concerns and suggestions that have been put forward.

I would be remiss if I did not note a special coincidence today. I understand that there will be a memorial service this afternoon for a legendary and well-respected member of the House, Mo Udall. As many know, Congressman Udall was one of the key forces in making the Postal Reorganization Act a reality in 1970. Indeed, as just one example of how far the Postal Service has come from its challenges in those early days, we should recall Mr. Udall's joking remedy for inflation in 1972: "Let's turn inflation over to the post office. That'll slow it down." I know our departed friend would be pleased to know that through the work he helped to begin – and especially because of the dedication of the hardworking postal workers – that joke no longer works.

Times have certainly changed, and the postal system he helped create has served this nation well for more than a generation. As we continue the journey of modernizing our nation's postal laws, I know that we will succeed if we infuse our efforts with the vision and bipartisanship that Congressman Udall and his colleagues brought to the table nearly 30 years ago.

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Mr. DAVIS. Well, thank you. Thank you very much, Mr. Chairman. And as you have already indicated, this may very well be the last in a set of hearings that we will have had on this very important matter. Therefore, I would like to thank all of those who have come before us as witnesses and those who have come today.

I am very much interested in hearing from all of them as we continue to engage in what I like to call this information-sharing process. Obviously, H.R. 22 is one of the biggest measures aimed at reforming or revamping, if you will, the U.S. Postal Service, and this is indeed a very complex bill. I must say that I still have some concerns with the long-term outcome of the price cap and the private law corporation as set up in the bill and how that pertains to and continues to protect and promote the rights of the consumer.

At the heart of this bill, as this committee deliberates on how to make the Postal Service compete more efficiently, I want to again pose the question and trust that all of us will continue to consider it, and that is at the bottom line, who does this bill really serve? Is it in the best interests of the individual consumer? We cannot get away from what the Postal Service's No. 1 priority ought to and must be, and that is delivering mail to the consumer in the most efficient and effective manner that we can generate. This means ensuring that both those who live in urban and rural areas get the mail for the same price and basically in the same manner.

Delivering mail has to be the top priority of our Postal Service and of our postal system. The consumer interest must be the bottom-line priority. I trust that we will get there, and I am sure that we will. So with you, Mr. Chairman, I look forward to hearing the witnesses and, again, thank you for the opportunity to comment and look forward to a very productive session.

Thank you very much.

Mr. MCHUGH. I thank the gentleman. I thank him and all of the Members on his side for their, not just cooperation, but their active participation in this process. It has been very helpful.

Before we go to our first witness, I would be happy to yield to the vice-chairman of the subcommittee, the gentleman from South Carolina, Mr. Sanford, if he has any opening comments he would like to make.

Mr. SANFORD. Thank you for doing so, but, no, I do not have opening comments.

Mr. MCHUGH. I thank the gentleman.

I mentioned during my opening statement that we had a last-minute change in the roster. We had, at the request of the minority, happily invited the Department of Treasury to present testimony, both for the record and in person, and until 1 o'clock—or 1:03 p.m.—we were under the impression that they were still going to appear. The empty seat you see is obvious testimony to the fact they did not appear, and apparently did not intend to, without ever informing at least our side.

I should note that I am very disappointed not only for what I think is a pretty clear act of a lack of common courtesy, in notifying people of your intentions, particularly when those intentions go contrary to your original statements, but also because I feel they had something to offer.

I am going to ask unanimous consent that Department of Treasury's written testimony be submitted for the record, although I have to admit to you I am somewhat tempted to strike it out because it is not all positive from my perspective, as you understand. But, in fairness, they do bring some valid concerns to the table.

I would like to believe that someone shared with them my scintillating, probing questions, and they were too frightened to show their faces, but that is probably not the case. It is probably something other than that.

So I am disappointed in Treasury and the absence of Lewis Sachs, who is Deputy Assistant Secretary of Government Financial Policy, who both submitted the testimony and we had expected to be here.

[The prepared statement of Mr. Sachs follows:]

EMBARGOED UNTIL 1 P.M. EST
Text as Prepared for Delivery
March 4, 1999

STATEMENT FOR THE RECORD

TREASURY DEPUTY ASSISTANT SECRETARY
(GOVERNMENT FINANCIAL POLICY)
LEWIS A. SACHS

HOUSE COMMITTEE ON GOVERNMENT REFORM
SUBCOMMITTEE ON THE POSTAL SERVICE

Chairman McHugh and distinguished Members of the Subcommittee, I am pleased to have the opportunity to submit this written statement on behalf of the Treasury Department with respect to H.R. 22, the "Postal Modernization Act of 1999."

The financial provisions in Title II of the current version of H.R. 22 are similar to those in earlier versions of the bill, which Treasury reviewed in letters dated September 24 and April 10, 1998. These provisions would segregate the finances and operations of the Postal Service into three distinct components: (1) Non-Competitive Postal, which would continue to be financed through the existing Postal Service Fund; (2) Competitive Postal, which would be financed through a newly created Competitive Products Fund in the Treasury; and (3) Non-Postal, which would be financed by a newly created corporation, the shares of which would be owned by the Competitive Products Fund.

The current bill includes new provisions designed to strengthen the proposed fire walls between the three proposed Postal Service components and to minimize the risks posed by the Competitive Products Fund. For example, under the bill, the proposed Competitive Products Fund would no longer be authorized to borrow from the Postal Service Fund. In addition, the Postal Service would be required to submit to the Secretary of the Treasury and the proposed new

RR-2998

Postal Regulatory Commission an annual report that would address such matters as risk limitations, reserve balances, allocations of monies, liquidity requirements, and measures to safeguard against losses.

While we support the new provisions and appreciate the Subcommittee's efforts to address Treasury's concerns, we continue to object to the financial provisions in Title II of the bill. Our concerns are as follows:

Borrowing. H.R. 22 would permit the Postal Service to borrow money for its Competitive Products Fund from the market, rather than continuing to borrow from the Federal Financing Bank (FFB). We object to this provision because we believe it would result in increased borrowing costs to the Postal Service. In accordance with longstanding Federal financial policies, Federal entities, such as the Postal Service, should borrow solely from the Treasury or the FFB because that is the least expensive, most efficient method of financing such debt. In fact, we have been receiving very positive feedback from the Postal Service about its borrowing relationship with the FFB.

Investment. The bill would permit the Postal Service to borrow on behalf of the Competitive Products Fund from the market at preferential rates due to perceived Government backing of the debt. The Competitive Products Fund could then invest any excess monies in the "Non-Postal" corporation; that corporation, in turn, could then invest in individual private companies. This scenario ultimately would allow the Postal Service to borrow at preferential rates and invest at potentially higher rates. Although the bill attempts to limit investment in private equities to the Non-Postal corporation, the corporation's ownership by the Competitive Products Fund and its financial links to the Postal Service create a situation in which the increased risks undertaken by the Non-Postal corporation could ultimately be borne by taxpayers.

Banking. The bill would permit the Postal Service to deposit funds from the Competitive Products Fund outside of the Treasury, without the Secretary of the Treasury's approval. In addition, the Postal Service would be permitted to move its funds in and out of the Competitive Products Fund at its sole discretion. Under existing law, the Postal Service banks at the Treasury and may not deposit funds outside of the Treasury without the Secretary of the Treasury's approval. As a matter of sound Government fiscal policy, this arrangement is necessary to allow centralized management of the Government's cash balances. If the financial exemptions and privileges proposed for the Postal Service were to become a precedent for all Federal agencies, Treasury's borrowing costs would be increased, and its cash management and forecasting abilities would be weakened. The Postal Service provisions cannot be considered in isolation. If other Federal entities were granted similar authorities as sought for the Postal Service, the adverse consequences on Treasury's management of Government funds would be severe. Additionally, the financing costs borne by those entities would be greater.

Non-Postal Corporation Although the bill classifies the new Non-Postal corporation as a private corporation, we view that entity as an on-budget Federal agency. As such, it should be required to borrow, bank, and invest with the Treasury and should be subject to the Federal oversight and regulations that govern such agencies. The Non-Postal corporation should be viewed as a Federal agency because it would be solely owned by the Competitive Products Fund, and thereby, would have strong links to the Postal Service, which is a Government entity. (Non-Governmental ownership is not contemplated for the corporation.) Moreover, the Non-Postal corporation would have a Federal charter and would be authorized to conduct postal business, which is perceived as a Governmental function.

In conclusion, Treasury cannot support the financial provisions in Title II of H.R. 22, as they are currently drafted. However, we look forward to working closely with the Subcommittee and the Postal Service to find ways to resolve our concerns with these provisions.

The Office of Management and Budget has advised that there is no objection from the standpoint of the Administration's program to the presentation of this statement.

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Mr. MCHUGH. But, nevertheless, in no way diminishing the first panel, we still are very fortunate to have with us a representative of the Department of Justice, Deputy Assistant Attorney General of the Antitrust Division, Donna Patterson, whom we welcome here this afternoon.

I will say for the public record what I said earlier, happy birthday.

Ms. PATTERSON. Thank you.

Mr. MCHUGH. You are welcome. And I know you are looking forward to finally drinking legally. [Laughter.]

With that, Ms. Patterson, again, in all seriousness, welcome. We are particularly happy now that you are here because we wouldn't have a panel 1 without you. [Laughter.]

And also because of your testimony. I have read your testimony and, as with all panels and witnesses, would ask unanimous consent that their prepared statements be entered in their entirety for inclusion in the record.

Also, before we begin, consistent with full committee rules, every witness before either the full committee or any of its subcommittees is required to take an oath. So if you would rise, please, and raise your right hand and affirm after me.

[Witness sworn.]

Mr. MCHUGH. The record will show that Ms. Patterson affirmed the oath.

Welcome. If you could summarize your statement, that would perhaps expedite things.

So, welcome, and we are all ears.

STATEMENT OF DONNA E. PATTERSON, DEPUTY ASSISTANT ATTORNEY GENERAL OF THE ANTITRUST DIVISION, DEPARTMENT OF JUSTICE

Ms. PATTERSON. Thank you, Mr. Chairman.

I am pleased to be here this afternoon to present the views of the Antitrust Division on H.R. 22, the Postal Modernization Act of 1999. My written statement and remarks present only the views of the Antitrust Division. The Division's comments should not be read as addressing issues outside our area of expertise or as reflecting the position of the Department of Justice or the administration with respect to overall postal reform.

Since passage of the Sherman Act in 1890, the United States has committed itself to protecting free and unfettered competition in the vast majority of markets in our economy. This reliance on free-market competition has served us well and provided numerous benefits to consumers, including more innovation, a greater choice of products, and lower prices.

The primary antitrust enforcement tools are sections 1 and 2 of the Sherman Act, which prohibit conspiracies and restraint of trade and monopolization, respectively, and section 7 of the Clayton Act, which prohibits mergers or acquisitions that may tend to substantially lessen competition.

In addition to our primary law enforcement activities, the Antitrust Division engages in a program of competition advocacy. Since the enactment of the Postal Reorganization Act of 1970, we have provided views with respect to postal issues in a variety of arenas.

We have challenged the efforts of the Postal Service to expand the scope of the protections afforded under the private express statutes and have suggested the need for a comprehensive review of competition in domestic and international markets for mail services.

A number of our prior efforts are listed in my written statement. Most recently, we supported the legislative amendment transferring responsibility for international postal policy from the Postal Service to the State Department. We applaud the subcommittee's efforts in spearheading and enacting that legislation. We believe it will have beneficial competitive consequences.

The Division's position with respect to the key competition policy issues affecting domestic and international mail consistently has been to promote competition where feasible. Accordingly, we have criticized attempts by the Postal Service to use its regulatory authority to expand the scope of the private express statutes, and we have opposed efforts to erect restrictions on competition in international mail services.

These positions are consistent with our general view that statutory exceptions to the Federal antitrust laws should be avoided whenever possible.

Federal competition policy objectives are best served when the Federal antitrust laws are applied uniformly rather than allowing the distortions that arise when special protections are given to classes of competitors or to selected industries.

I would like to turn now to the proposed legislation. First and foremost, I want to commend the subcommittee for ensuring that competitive principles play an important role in Postal Service reform. Today, competitors have entered a number of the activities formerly carried out only by the Postal Service. At the same time, it appears unlikely that other entities currently have the infrastructure necessary or the desire to compete for general First Class Mail delivery at the size and scope necessary to preserve universal service of mail delivery.

The policy question that the proposed legislation addresses is whether an acceptable system can be devised to put the Postal Service on roughly the same footing as others in the areas in which it faces competition, while ensuring that the Postal Service continues to have the ability to meet the requirements of its universal service obligation efficiently.

H.R. 22 recognizes the distinction between the Postal Service's universal service obligation and its participation in newly competitive markets by treating these services differently.

From the perspective of competition policy, the goal and intent of the legislation to enhance the ability of the Postal Service to participate in competitive markets, while at the same time addressing concerns about cross-subsidization, is a step in the right direction.

A significant aspect of the legislation is the move from cost-based to price-cap regulation for the Postal Service's monopoly products. In many instances, price-cap regulation systems have advantages over cost-based price regulation because price cap systems tend to create greater incentives to lower costs and to increase efficiency.

One of the keys to implementing the regulatory pricing scheme contained in the legislation will be to ensure that an appropriate cost-allocation methodology is adopted. Another important compo-

ment of the new structure is the application of the antitrust laws to the Postal Service for activities relating to its nonmonopoly products.

I would like to turn now to comments on two specific provisions of the bill, section 305 and section 603. Section 305 appears to create a regulatory scheme under which the Postal Regulatory Commission would proscribe regulations to enforce statutory requirements that the Postal Service not, among other things, create any competitive advantage for itself or any other party. We would like to discuss this section with the subcommittee.

We are concerned that, without clarification, the standards in this section may diverge from the antitrust laws. We are also concerned that future interpretations of the section could lead to unintended consequences such as disputes over the meaning of competitive advantage or the chilling of legitimate procompetitive behavior. We welcome the opportunity to work with the subcommittee on this issue.

Section 603 would require the Department of Justice to prepare a comprehensive report identifying Federal and State laws that apply differently to competitive products of the Postal Service than to products of other companies. The Department of Justice is not an appropriate agency for such an assignment. We are concerned that such a requirement would require us to divert scarce resources from our law-enforcement activities and, therefore, detract from the appropriate enforcement of the antitrust laws. We respectfully request that if this reporting requirement is retained as the legislation goes forward, the job be assigned to a more appropriate agency.

I would like to finish my remarks by again noting that the promotion of competition, where possible, should be an important goal in any Postal Service reform, and I thank the subcommittee for taking important steps in that direction.

I am ready to answer your questions.

[The prepared statement of Ms. Patterson follows:]



DEPARTMENT OF JUSTICE

Statement by

DONNA E. PATTERSON
Deputy Assistant Attorney General
Antitrust Division
U.S. Department of Justice

Before the

Subcommittee on Postal Service
House Government Reform Committee

on

H.R. 22, "The Postal Modernization Act of 1999"

Washington, D.C.
March 4, 1999

I am pleased to be here this morning to present the views of the Antitrust Division on H.R. 22, the Postal Modernization Act of 1999. My written statement and remarks here this morning present the views of the Antitrust Division and do not purport to address issues outside of our areas of expertise. Therefore, the Division's comments should not be read as reflecting the position of the Department of Justice or the Administration with respect to overall postal reform. At the outset, I would like to provide a brief overview of the antitrust laws of the United States and then turn to thoughts about the Postal Service and some thoughts about H.R. 22.

THE ANTITRUST LAWS OF THE UNITED STATES

I would like to start by discussing the purpose and scope of the antitrust laws. For over a century, the United States has committed itself to protecting free and unfettered competition in the vast majority of markets in the economy. The Sherman Act, passed in 1890, has been called the Magna Carta of free enterprise. In general, the United States operates a free-market economy subject to the antitrust laws. Time and again, relying on free-market competition has allowed consumers numerous benefits, including more innovation, more choice and lower prices than that of economies where free competition has been limited.

The main provisions of the Sherman Act are Section 1 and Section 2 of the Act, and they are, in conjunction with Section 7 of the Clayton Act, the primary antitrust enforcement tools. Section 1 of the Sherman Act prohibits contracts and conspiracies in restraint of trade. Section 2 of the Sherman Act prohibits monopolization or attempts to monopolize. Section 7 of the Clayton Act prohibits mergers or acquisitions that may tend to substantially lessen competition. Let me spend just a little more time on the types of activity that may violate these sections of the antitrust laws.

Collusion, which means that firms are agreeing with each other to restrain competition among themselves, is a violation of section 1 of the Sherman Act. It virtually always results directly in inflated prices to consumers and denial of choices in the marketplace; indeed, that is its purpose. The most common of these agreements are agreements to fix prices, agreements to allocate markets, and agreements to boycott particular customers, suppliers, or competitors. Price fixing includes not only agreeing on the specific price, but also agreeing to increase or depress price levels, or agreeing to follow a formula that has the intended effect of raising or depressing prices or price levels. Allocation of markets includes not only agreeing to divide up geographic areas to avoid competition, but also agreeing to divide up customers or suppliers within an area, or agreeing to divide up a sequence of bids. Group boycotts include any agreement among competitors that they will deal with their customers or their suppliers only on particular terms.

A second type of antitrust violation is monopolization or attempting to monopolize, which violates section 2 of the Sherman Act. Under section 2, it is not necessary to prove an agreement. One firm can illegally monopolize by itself. But section 2 monopolization cannot be proved just by showing that a firm has engaged in restrictive conduct. The law also requires proof that the firm has a monopoly and that it engaged in the restrictive conduct in order to acquire or maintain the monopoly. Or, in the case of attempted monopolization, it must be proved that the firm stands a "dangerous probability" of obtaining a monopoly as a result of the restrictive conduct. To prove "dangerous probability," the courts generally require, for starters, that the firm involved in the restrictive conduct already has a quite large market share. And even a large market share might not be enough, if other facts indicate that the restrictive conduct is

unlikely to succeed in creating a monopoly.

In addition to prohibiting anticompetitive collusion and monopolization, the antitrust laws also prohibit anticompetitive mergers and acquisitions. A merger or acquisition that may substantially lessen competition in a product market and geographic market violates section 7 of the Clayton Act. Under Clayton Act merger review, the principal focus is whether the merger would change the incentives and ability of competitors to such a degree that competition would be substantially lessened. The remedy for a merger that violates the Clayton Act typically is to sue to stop the merger, or to insist that it be modified to remove the cause for antitrust concern.

The Division analyzes mergers pursuant to Horizontal Merger Guidelines developed jointly by the Department of Justice and the Federal Trade Commission (the Antitrust Division shares civil antitrust enforcement responsibility with the Federal Trade Commission). The analysis is aimed at determining whether the merger is likely to create or enhance market power, or to facilitate the exercise of market power, in any relevant market. Market power is the ability of a firm or group of firms to raise the price they charge to customers -- or to lower the price they pay to suppliers -- a small but significant amount without being defeated by competitive responses by other competing firms.

PAST JUSTICE DEPARTMENT VIEWS ON POSTAL ISSUES

Since the enactment of the Postal Reorganization Act of 1970, the Department has engaged in an active program of competition advocacy with respect to postal issues. In appearances before the Rate Commission and in various Executive Branch communications, the Department has challenged efforts by the Postal Service to expand the scope of the protections afforded under the Private Express Statutes. We have suggested the need for a comprehensive

review of competition in domestic and international markets for mail services, noting the USPS's expansion into competitive markets and the many ambiguities surrounding its legal status under the Private Express Statutes. These are some of the issues we have addressed:

- In 1977 the Department of Justice issued a report on the Private Express Statutes which examined the basis of the postal monopoly and suggested competitive alternatives.
- In 1979 the Antitrust Division submitted comments to the Postal Service on the competitive impact of its regulations and urged the repeal of regulations treating "data processing materials" as within the scope of the term "letter" as used to delineate the scope of the postal monopoly.
- In 1986 the Antitrust Division prepared comments urging the USPS to suspend or limit its International Priority Airmail Service pending development of a factual record adequate to ensure against anticompetitive cross-subsidization; in a separate proceeding the Antitrust Division urged the USPS to reject proposed rules that would restrict the ability of remail services to compete for international mail traffic.
- In 1988 the Antitrust Division submitted comments critical of the USPS proposal for modifications to the terminal dues system for delivery of international mail.
- In 1991 the Antitrust Division reiterated its opposition to the USPS proposal for modifications to the terminal dues system.
- Most recently, the Department of Justice prepared written comments in response to Chairman McHugh's request for views on the antitrust and competition policy provisions in H.R. 22. Our August 1998 letter continues to have general application to H.R. 22, notwithstanding modifications that may have been made to the bill currently under consideration.

Last year we also took an active role in urging support for a legislative amendment transferring responsibility for international postal policy from the USPS to the State Department. The President signed the measure into law, thus formalizing the end of the USPS' direct representation of US interests at meetings of the Universal Postal Union, the international standards-setting body.

The Department's position has not wavered on key competition policy issues affecting domestic and international mail. In the years since the reorganization of the United States Post Office, we have been critics of attempts by the USPS to use its regulatory authority to expand the scope of the statutory protections afforded by the Private Express Statutes, and we have opposed efforts to erect restrictions on competition in international mail services.

Furthermore, the Department takes the firm position that statutory exceptions to the federal antitrust laws should be avoided whenever possible. Federal competition policy objectives are best served when the federal antitrust laws are applied uniformly, rather than allowing them to be distorted to give special protections to certain classes of competitors or to selected industries or economic sectors. We believe that Congress should create exceptions to the antitrust laws only in the exceedingly rare instances when the government's strong interest in preserving competition is outweighed by a compelling and irreconcilable social policy objective, and that even in those rare instances the exception should be as narrowly drawn as possible.

THE PROPOSED LEGISLATION

Until recently, there has not been serious legislative focus on possible modernization of the United States Postal Service since the enactment of the Postal Service Modernization Act of 1970. Given that almost three decades have passed, with accompanying technological and other changes, it is not surprising that thought would again be given to whether changes to the regulatory system in which the Postal Service operates are appropriate.

In broad overview, the Postal Service now engages in a number of activities which can be considered competitive. For example, there are a number of options for people to send material to a recipient quickly (that is within 1 or 2 days), typically referred to as express mail. At the

same time, it appears unlikely that other entities currently possess the infrastructure necessary to compete for general first-class mail delivery at the size and scope necessary to preserve universal service of mail delivery.

Given these competing observations, the question for policy makers is whether an acceptable system can be devised to put the Postal Service on roughly the same footing as other competitors in those areas in which it faces competition. Such a system should ensure that the Postal Service has neither inherent advantages nor disadvantages over other competitors, while ensuring that the Postal Service has the ability to efficiently meet the requirements of the universal service obligation and provide the service for which they do not face competition.

This legislation recognizes that certain of the activities currently engaged in by the Postal Service, such as express mail, are subject to competition. Other services, such as regular first-class mail, retain an important universal service policy dimension and are not subject to full competition at this point in time. The legislation attempts to deal with this dichotomy by treating the competitive and monopoly services differently.

Under the legislation, price regulation on competitive products is limited substantially, requiring only that the prices established by the Postal Service cover the direct and indirect postal costs attributable to such products. Competitive products collectively must bear at least an equal proportional mark-up for institutional costs as do all non-competitive and competitive products combined. The rationale behind such a requirement -- that the Postal Service should not be allowed to subsidize its competitive activities by loading up its overhead costs in the non-competitive category of products, for which it earns a guaranteed return -- is a legitimate competitive concern of cross-subsidization. At the same time, the intent of the legislation is that

as long as the cross-subsidization is avoided, the Postal Service will have the same freedom to price its competitive goods and services as its competitors. An important corollary to this structure is that the intent of the legislation is to subject the Postal Service to the antitrust laws for activities related to non-monopoly products.

This structure seems to place the Postal Service closer to equal footing with its competitors with respect to competitive products. It allows greater flexibility to the Postal Service while, at the same time, subjecting it to the same antitrust laws that its competitors face. It provides more pricing flexibility to the Postal Service while attempting to ensure that inappropriate subsidization does not occur. Of course, one of the keys in implementing such a regulatory pricing system will be to ensure that direct and indirect costs are appropriately taken into account.

With respect to services for which the Postal Service remains a monopoly provider, the legislation revises the price regulation method, going from a cost-based system to a price-cap regulatory system. In general, price-cap regulation tends to have advantages over a pure cost-based system in many instances. The prime concern with a cost-based system is that the incentives for cost control are seriously lacking and often inefficiency prevails. In a price-cap system, on the other hand, there is more of an incentive for attempting to lower the cost of the provision of the regulated services, since cost savings can be retained by the entity subject to the price-cap regulation. At the same time, since the mere increase in costs would not subject rates to increases, there is likely to be less of an incentive to attempt to misallocate costs from the competitive services to the monopoly services.

I would like to turn now to comments on two specific provisions of the legislation,

section 305, "Unfair Competition Prohibited" and section 603, "Equal Application of Law to Competitive Products." Section 305 appears to create a regulatory regime pursuant to which the Postal Regulatory Commission would prescribe regulations to enforce statutory requirements that the Postal Service not, among other things, create any competitive advantage for itself through regulation or any agreement. We would like to discuss this section with the subcommittee. We are somewhat concerned that the standards contained in this section appear to diverge from the antitrust laws, and about the availability of different forums for addressing the same conduct. It could be possible that legitimate and procompetitive business practices may be inhibited by this section. It may be that our concerns can be resolved by additional discussion.

Section 603 would require the Department of Justice to prepare a comprehensive report identifying Federal and State laws that apply differently to products of the Postal Service in the competitive category of mail and similar products provided by private companies. The Department of Justice is not an appropriate agency for such an assignment. We are a law enforcement agency and have neither the resources nor the expertise with State law to conduct such a study. We are concerned such a requirement would require resources to be taken from antitrust law enforcement and therefore detract from the appropriate enforcement of the antitrust laws. We respectfully request that if this reporting requirement is retained as the legislation goes forward, the job be assigned to a more appropriate agency.

CONCLUSION

Competition principles are at the core of the American economy and should be maximized to the fullest extent possible in reform legislation. We look forward to continuing to work with the Subcommittee on the important issue of postal reform.

Mr. MCHUGH. Thank you very much, Ms. Patterson.

I had planned to bring the two departments, Treasury and Justice, together at least insofar as discussion of what I think are important issues regarding competitiveness and the areas of concern raised by Treasury. That is not going to be possible here today.

Let me just ask you a particular question. It is actually a generic question. Is it fair of me to say that, whether we are dealing with a Postal Service or any other business-type organization, the questions of borrowing and banking and such are indeed an issue of competitiveness, and that inequitable treatment between two sectors can, in fact, lead to an unlevel playing field? So, in other words, if one borrower has a particular advantage or a particular situation, that by law enriches it above another, isn't that an issue of competitiveness?

Ms. PATTERSON. I am not prepared to comment on the Treasury Department's views on this.

Mr. MCHUGH. Just the question I asked.

Ms. PATTERSON. With respect to competitiveness and a level playing field, our goal in enforcing the antitrust laws and thinking about appropriate antitrust laws, is always to have competitors subject to the same scheme of laws and regulations.

By a level playing field, I think what we generally mean is an equal opportunity to compete, not absolute equality in every characteristic. Indeed, I would be hard pressed to think of an industry where every competitor had the same characteristics, the same borrowing power or the same quality of trademark. So I think differences among competitors are inherent in competition, and it is the opportunities afforded them to compete that need to be level.

Mr. MCHUGH. Mr. Sachs, what do you have to say for yourself? Oh, he is not here. [Laughter.]

I appreciate that. But given the absence of Treasury, I will just move to two quick questions I have specifically relating to your testimony and two things that you mentioned.

The first being, and both of them are on page 9 of your testimony, you talked about the concerns that you have with respect to the assignment of responsibilities that Justice has in identifying certain Federal and State laws that inure certain benefits or apply differently to the Postal Service, and you asked that it be assigned to a more appropriate agency. I don't disagree with that but I am curious, do you have a suggestion as to which more appropriate agency we might assign them to?

Ms. PATTERSON. I don't have a particular agency in mind. We don't have any comparative advantage with respect to State laws or, indeed, with respect to all Federal laws. We really only know about the antitrust laws.

I believe there are other agencies that do—regulatory and reporting agencies—that do such studies from time to time, and I would think one of them would be more appropriate.

Mr. MCHUGH. If we could ask then that you and your people give some thought to that, because we are perfectly willing to consider it. It wasn't really an attempt to punish you, I assure you, and you may view it differently.

Ms. PATTERSON. We didn't interpret it that way.

Mr. MCHUGH. But we want to, where possible, assign these kinds of things to the most appropriate agency. So if you have any specific thoughts, as we go along, we would be very interested.

Ms. PATTERSON. We would be happy to provide you with our thoughts.

Mr. MCHUGH. Thank you very much. The other is your reference to section 303, which was stated above that. We are somewhat concerned that the standards contained in the mentioned section appear to diverge from the antitrust laws and about the availability of different forums for addressing the same conduct. It could be possible that legitimate and procompetitive business practices may be inhibited by this action. You then go on to say that we want additional discussion. I appreciate that.

But I just thought for the purposes of your appearance here today, do you have any specific examples or generically specific examples about what kind of procompetitive business practices may, in fact, be inhibited? What kinds of areas are we likely—

Ms. PATTERSON. With respect to subsection 4 of section 305, I think it is possible that that prohibition on the Postal Service could prevent the Postal Service from providing information to its customers about all competitors who provide a certain service, and I think that would be legitimate procompetitive behavior that would be affected by that subsection.

Mr. MCHUGH. Well, there are two. You offered kindly for further discussion, and we will certainly take you up on that. I appreciate it.

I am going to, with great appreciation, recognize the chairman of the full committee, who has joined us and, who I should say, before I do yield, has been a great leader and a great supporter in this process. He was at our last subcommittee hearing as well, and we're delighted he has been able to take at least a few minutes to be with us here today, the gentleman from Indiana, Chairman Burton.

Mr. Chairman, welcome.

Mr. BURTON. Thank you, Mr. Chairman.

I just came here to be educated, and I really appreciate all of the hard work you have done.

I have a statement for the record I would like to submit.

Mr. MCHUGH. Without objection, sir.

[The prepared statement of Hon. Dan Burton follows:]

STATEMENT OF THE HONORABLE DAN BURTON
SUBCOMMITTEE ON THE POSTAL SERVICE
MARCH 4, 1999

TODAY THE POSTAL SERVICE SUBCOMMITTEE IS HOLDING ITS SECOND HEARING ON H.R. 22, THE POSTAL MODERNIZATION ACT OF 1999.

I ESPECIALLY WANT TO TAKE THIS OPPORTUNITY TO AGAIN PAY TRIBUTE TO CHAIRMAN MCHUGH FOR HIS YEARS OF HARD WORK ON BEHALF OF POSTAL REFORM. HE HAS BEEN SECOND TO NONE IN WORKING TO BUILD A CONSENSUS ON POSTAL REFORM AND PRODUCE A BILL THAT, TO THE MAXIMUM EXTENT POSSIBLE, INCORPORATES THE RECOMMENDATIONS THAT HAVE BEEN BROUGHT BEFORE HIS SUBCOMMITTEE.

AS I SAID IN MY OPENING STATEMENT AT THE SUBCOMMITTEE'S LAST HEARING, POSTAL REFORM REMAINS A WORK IN PROGRESS. H.R. 22 IS WRITTEN IN INK, NOT IN CONCRETE. THE PURPOSE OF THIS AFTERNOON'S HEARING IS THE SAME AS THE FEBRUARY 11TH HEARING: THE SUBCOMMITTEE WANTS TO IDENTIFY CONCERNS ABOUT H.R. 22 AND LOOK FOR WAYS TO ADDRESS THEM. I SHOULD ADD THAT WHILE THIS IS A WORK IN PROGRESS, I STRONGLY BELIEVE THAT THIS INITIATIVE PRESENTS AN ALTERNATIVE THAT IS FAR SUPERIOR TO CURRENT LAW. THE POSTAL SERVICE, POSTAL EMPLOYEES, MAILERS, AND THOSE PRIVATE FIRMS WHO COMPETE WITH THE POSTAL SERVICE WOULD ALL BE BETTER OFF UNDER THIS BILL.

I STRONGLY BELIEVE THAT THE POSTAL SERVICE SHOULD NOT USE REVENUES DERIVED FROM ITS MONOPOLY IN REGULAR MAIL SERVICE TO SUBSIDIZE ITS SERVICES THAT COMPETE AGAINST THE PRIVATE SECTOR. BUSINESSES WHICH COMPETE WITH THE POSTAL SERVICE HAVE A RIGHT TO EXPECT THAT THERE IS NO CROSS-SUBSIDIZATION. I'M ALL FOR KEEPING POSTAL RATES AFFORDABLE, BUT THIS SHOULD NOT BE DONE BY THE POSTAL SERVICE UNFAIRLY COMPETING AGAINST HARDWORKING BUSINESS OWNERS. IN H.R. 22, CHAIRMAN MCHUGH HAS ADDRESSED THIS VERY IMPORTANT ISSUE HEAD-ON BY SEPARATING THE POSTAL SERVICE'S COMPETITIVE PRODUCTS FROM ITS NON-COMPETITIVE PRODUCTS, AND CREATING A PRIVATE LAW CORPORATION TO GUARANTEE A LEVEL PLAYING FIELD FOR NON-POSTAL PRODUCTS.

H.R. 22 IS THE VEHICLE AND I HOPE YOU WILL HAVE THE VISION TO SUPPORT AN ENACTABLE BILL, RATHER THAN SEARCH FOR THE PERFECT LEGISLATION. I KNOW MANY OF YOU HAVE SPECIFIC PROBLEMS WITH THE BILL BUT I HOPE YOU WILL REASON THAT THE PLUSES FAR OUTWEIGH THE MINUSES.

WHILE COMMUNICATION MOVES INTO THE 21ST CENTURY WITH ELECTRONIC MAIL, FAXES, AND UNIMAGINABLE DEVELOPMENTS IN COMMUNICATION, IT IS IMPERATIVE THAT YOU LOOK INTO A CRYSTAL BALL AND TRY TO ENVISION WHERE THE POSTAL SERVICE IS HEADED WITHOUT ANY CHANGE. *WITHOUT SUBSTANTIAL CHANGE IN THE STATUS QUO I AM AFRAID WE WILL BE PRESIDING OVER THE ULTIMATE SELF-DESTRUCTION OF THE POSTAL SERVICE.* I WOULD HOPE THAT ALL OF YOU HAVE THE FORWARD VISION TO WORK JOINTLY WITH CHAIRMAN MCHUGH AND MYSELF AS WE TRY TO PRESERVE UNIVERSAL DELIVERY AND ALLOW THE POSTAL SERVICE THE ABILITY TO MODERNIZE IN A FAIR AND EQUITABLE MANNER.

THANK YOU MR. CHAIRMAN AND I LOOK FORWARD TO HEARING FROM OUR WITNESSES TODAY.

Mr. BURTON. Do you know where Mr. Sachs is?

Mr. MCHUGH. Well, funny you should ask. Actually, Mr. Chairman, I expressed a great level of disappointment. We learned at 1 o'clock, or perhaps a few minutes after, that Treasury did not intend to send a representative.

Mr. BURTON. Was there any reason they gave or anything?

Mr. MCHUGH. To this moment, we have not, to my knowledge, received, on our side, any kind of indication. Apparently, there was some contact with the minority side, but I think they would agree with me that it was late, and it was less than decisive, and we received no indication at all.

Mr. BURTON. Mr. Chairman, let me just say that if you require witnesses to be here and they choose not to be here, we will be very happy to assist you by issuing a subpoena to make sure they are here. We will contact Mr. Sachs and find out why he wasn't here because you deserve the respect that is due your position. You have worked on this issue for about 4 or 5 years. So we will talk to Mr. Sachs and make sure he never does this again.

Thank you.

Mr. MCHUGH. Thank you, Mr. Chairman, and we will keep that in mind. I would prefer to subpoena people who support the bill, however. [Laughter.]

Before we proceed to the minority for questioning, we have been joined, also, by the gentleman from Ohio, Mr. LaTourette, one of the original subcommittee members who, as I mentioned last time, continues to voluntarily serve, so that deserves recognition. I would be happy to yield to him if he has any opening comments.

Mr. LATOURETTE. I will wait.

Mr. MCHUGH. I thank the gentleman.

At this time I would yield to the gentleman from New York, Mr. Owens, for any comments or questions.

Mr. OWENS. No questions.

Mr. MCHUGH. Well, Ms. Patterson, we thank you.

Oh, I am sorry, Mark. Mr. Sanford—

Mr. LATOURETTE. Mr. Chairman, I am sorry. I thought you were asking me for opening remarks.

Mr. MCHUGH. I am asking you for whatever you want to throw out there, Steve.

Mr. LATOURETTE. Then hang on just a second. I apologize.

I was going to save my opening remarks until my pithy questions, and I just have, Ms. Patterson, a couple of questions that relate to the last hearing with the Postmaster General, and I think he, in his testimony, made some observations that were a little alarming to me and some other members of the subcommittee as well.

We always hear about foreign government subsidization of industry. People in the steel industry are now coming to us saying their companies are subsidizing the steel industry and putting our industries at a disadvantage. I think he mentioned Germany in particular, and I think he mentioned England as well; wherein, they had sort of gotten big time into the mail business. The concern was that with the leverage created by not only the Government being behind that enterprise, but also their involvement in private cor-

porations, that they were going to be putting the U.S. Postal Service at a disadvantage.

Relative to your comments and observations on antitrust, I am just wondering whether or not the Department of Justice has ever taken a look at the potential antitrust implications of someone other than the U.S. Postal Service or some of the competitors that are going to testify before us today as it comes to a monopolization of mail products abroad.

Ms. PATTERSON. I don't believe that we have ever had concerns of that sort addressed to us in the context of specific behavior. Generally, we investigate specific behavior that is alleged to be harming competition at the time.

Mr. LATOURETTE. Then the second question is we are going to hear from not only customers, but also competitors of the U.S. Postal Service today. Are you aware of any information the Department of Justice has on complaints or cases against the major competitors of the U.S. Postal Service relative to antitrust violations or monopolization?

Ms. PATTERSON. Not as I sit here today, I am not aware of any specific investigations that are underway, although we get complaints from time to time from a lot of quarters about a lot of things, and we generally investigate them at the level that we believe appropriate at the time.

Mr. LATOURETTE. And, last, as I read your testimony and also heard you testifying about, you had some concerns about the responsibilities that H.R. 22 would deliver to the Department of Justice under section 603, and it is your observation that that should go to a more appropriate agency than Department of Justice because of manpower constraints and things? Do you have a suggestion as to who would be more appropriate?

Ms. PATTERSON. As I said to the chairman, I don't have a suggestion about a specific agency, but we have agreed to give that some thought and get back to the subcommittee with any suggestions we have.

Mr. LATOURETTE. Thank you very much.

Ms. PATTERSON. Thank you.

Mr. LATOURETTE. I thank the Chair.

Mr. MCHUGH. Again, Ms. Patterson, thank you for being here. As we have already discussed on several occasions, we are looking forward to working with you, particularly on those two sections and we appreciate that opportunity.

Ms. PATTERSON. Thank you. We look forward to working with the committee.

[Additional questions for the record follow:]



U.S. Department of Justice
Office of Legislative Affairs

Office of the Assistant Attorney General

Washington, D.C. 20530

July 22, 1999

The Honorable John McHugh
Chairman
Subcommittee on the Postal Service
Committee on Government Reform
U.S. House of Representatives
Washington, DC 20515

Dear Chairman McHugh:

I am forwarding Deputy Assistant Attorney General Patterson's written responses to the follow-up questions enclosed in your March 16, 1999 letter. The Department of Justice appreciates the opportunity to have participated in the subcommittee's March 4, 1999 hearing on H.R. 22, the "Postal Modernization Act of 1999." The Office of Management and Budget has advised us that from the perspective of the Administration's program, there is no objection to submission of this letter.

Sincerely,

A handwritten signature in cursive script that reads "Jon P. Jennings".

Jon P. Jennings
Acting Assistant Attorney General

**Deputy Assistant Attorney Donna E. Patterson
Answers to Follow-up Questions from
March 4, 1999, Hearing on**

H.R. 22, *The Postal Modernization Act of 1999*

**Committee on Government Reform
Subcommittee on the Postal Service**

Questions from Mr. Fattah

1. **In your testimony, you state that you have suggested the need for a comprehensive review of competition in domestic and international markets for mail service. Specifically, what should such a review encompass and who should conduct such a review? Should such a review come before consideration of H.R. 22?**

My statement referred to the fact that the Department has long advocated the need to reconsider the policy justifications for the creation of a statutory monopolist for the delivery of mail services. Chairman McHugh and the staff of the Postal Reform Subcommittee have compiled an extensive record of testimony and other information addressing reform issues. I think that the issues are set out; what is lacking at this point is a consensus on how to go about addressing those issues.

2. **You note in your testimony the postal services' expansion into competitive markets and the many ambiguities surrounding its legal status under the private express statutes. Please clarify those ambiguities for us? Does H.R. 22 address them? If not, should the bill incorporate your concerns in this area?**

The Private Express Statutes are comprised of Federal laws enacted in an era that bears little resemblance to our own. Unlike the Federal constitution or the Sherman Antitrust Act, the Private Express Statutes are not laws for the ages. The relative obscurity of the Private Express Statutes did not go unnoticed by Congress when it enacted in the Postal Reorganization Act. The 1970 Act contained provisions for a study by the USPS Board of Governors of the problem followed by recommendations for modernization. The Board concluded that the laws could be made relevant through administrative interpretation; however, there is general agreement that this approach only compounded the problem.

New laws may be needed that can address the vast changes brought about by time and technology. H.R. 22 proposes to do this by clarifying the scope of the postal monopoly. It proposes a bright line test based on price and weight, with adjustments for inflation. The Administration is looking at this approach.

3. How competitive can the postal service become and still be a government entity?

The normal presumption in a market economy is that private enterprises should provide goods and services. Competition between private companies yields cost efficiencies and innovation. Government provision of a good or service typically is justified only when a free and private market fails to provide it. While the extensive services provided by private carriers of parcel post, express mail, and package delivery demonstrate the absence of market failure in certain postal contexts, the objective of universal service may justify the government's entry into competitive markets.

4. What benefits do postal consumers, customers and the general public derive from applying the antitrust laws to the postal service?

The antitrust laws are premised on the conviction that market forces are generally the most reliable motivator for efficiency, innovation, and consumer service. The goal of antitrust enforcement is to ensure that market forces are permitted to work. The direct goal of an antitrust enforcement action is to stop anticompetitive agreements and monopolistic conduct that interfere with the healthy competitive functioning of the marketplace. Consumers benefit when market dynamics reflect a competitive situation. Consumers are at risk whenever external, non-market forces disrupt market dynamics. Unlike regulatory oversight -- which has the potential to significantly affect market dynamics -- antitrust enforcement provides a highly effective deterrent against unreasonable restraints of trade without resort to a more intrusive regime of government oversight, thus benefitting postal consumers, customers, and the general public alike.

5. Will the application of the antitrust laws harm the postal service's labor force? Please explain.

Labor concerns are an important consideration in any industry as labor-intensive as the USPS, for labor relations are a critical factor in containing costs and in enhancing efficiency and productivity. However, labor issues are not directly relevant to competition policy analysis. The Antitrust Division does not have a position on the labor issues relevant to H.R. 22 except emphasize the need for evaluating competition policy concern on the merits, reserving any final balancing of interests until there is a clear understanding of all competing policy interests, if any.

6. Why are the antitrust laws better than regulation for preserving competition?

An effective antitrust enforcement program provides a bulwark against the anticompetitive use of market power to reduce consumer choice, chill economic freedom, and retard innovation. Unlike regulation, vigorous antitrust enforcement deters anticompetitive conduct without the creation of pervasive regulatory regimes, which can and do exert dampening effects on the marketplace.

7. The postal service is worried that they will face a flood of lawsuits if the antitrust laws are applied to their activities. Is this a legitimate concern? Please explain.

This is a concern of all firms to which the antitrust laws apply. It bears full consideration only if there is a demonstrable policy justification for shielding the USPS non-monopoly activities

from antitrust scrutiny. As a general rule, we disfavor exemptions or protections that set one class of competitors apart from others under the law.

Mr. MCHUGH. Thank you very much. Thanks for being here, too. [Laughter.]

The next panel is made up of two very distinguished gentlemen: Mr. Fred Smith, who is chairman and chief executive officer of the Federal Express Corp.; and Mr. James P. Kelly, who is president and chief executive officer of United Parcel Service.

I asked staff if they were here, and someone said, "Gee, I haven't seen them, and I hope they are not with Mr. Sachs." [Laughter.]

So these two guys walk into a bar. The first guy says—[laughter.]

They are checking to see if they are in a holding room. I didn't know we had one, but—[laughter.]

[Pause.]

Mr. MCHUGH. Have you gentlemen seen Lew Sachs? [Laughter.]

To let you in on that, he was the gentleman on the first panel who didn't show up, and we were beginning to worry you three were together somewhere. [Laughter.]

Mr. SMITH. We were right behind the door, but it still took us 10 minutes to get here.

Mr. MCHUGH. I said awfully nice things about you while you were out of the room. I will show you the record later.

I do deeply appreciate you two gentlemen being here. You both have extraordinarily busy schedules, extraordinarily successful companies, and are most gracious in agreeing to be here today and to give up some of your valuable time in helping us to go over this issue. In that regard, we have also appreciated very much the opportunity to work with both of you personally, but on a continuing basis with your representatives who have been fully engaged in this process, as you know. You have provided a great service, certainly to the subcommittee, but I think to the entire country on this important matter.

As I mentioned with the abbreviated first panel, we have made both of your statements part of the record and entered them in their entirety, and we appreciate the work and thought that went into those. I have read them both. I would yield to you now for the opportunity to make an oral presentation. But before we do, the subcommittee and committee rules require, as I think both of you have done in the past, ask you to rise and to affirm an oath. If you would do that, please, gentlemen and raise your right hands.

[Witnesses sworn.]

Mr. MCHUGH. The record will show both witnesses responded in the affirmative.

With that, welcome. I am going to, for no other reason than this is how they are listed here—this is no reflection on seniority, no reflection on success, no reflection on anything other than that this is how they were typed—I will yield first to Mr. Smith who, as I said, is chairman and CEO of FDX, and welcome him and pay our attention to you, sir, as you make whatever comments you would like to at this time.

STATEMENTS OF FRED SMITH, CHAIRMAN AND CHIEF EXECUTIVE OFFICER, FDX CORP.; AND JAMES KELLY, CHAIRMAN AND CHIEF EXECUTIVE OFFICER, UNITED PARCEL SERVICE

Mr. SMITH. Thank you very much, Mr. Chairman. I am delighted to be here representing tens of thousands of employees and independent operators that drive the FDX system, two primary components of which are Fed Ex and RPS.

I am delighted to be here with my friend, Jim Kelly, as well, representing the fine folks at UPS. I think both our companies have many more similarities in outlook on this matter than disagreements. In fact, I think we would both very much like to end up in exactly the same place, and whatever disagreements we have are probably as to how best to get there.

In that regard, as you know, we support H.R. 22 and think that it is a good piece of legislation, well thought out, that takes the country, and our industry and, for that matter, the Postal Service in the direction that it should and must go in the 21st century.

I think it is important to look at this issue from a broader perspective than is often the case. In that regard, the way I characterize what the Postal Service is trying to do today is what private business would call a diversification.

As you well know, the Postal Service was given a monopoly in 1871 to carry letters. And the primary justification for that was to provide universal service and the primary commercial ties for an expanding nation.

In the early part of the 20th century, the Postal Service began to add, in addition to their letter traffic, the movement of publications and physical goods, and over a number of years developed a substantial business in that regard.

Then in the middle part of this century—and Mr. Kelly could tell you a lot more about it than I can because his company was right in the middle of it—the Postal Service, in essence, withdrew from the goods delivery business. One of the reasons that they did was that they found that the operating systems—the vehicles, the post offices and so forth—could either be optimized for the delivery of letters, and publications and small items or they could be optimized for the delivery of packages, but not both. To put it in very simplistic terms, it is one thing to be delivering letters in a small jeep vehicle with a right-hand drive in your neighborhood, and it is quite something else to be delivering parcels which require the capabilities of step vans of the type operated by UPS or Fed Ex or RPS.

UPS became the primary parcel delivery entity in this country, and only recently has the USPS begun to turn its attention away from the delivery of letters and small items back to the delivery of goods, both in this country, and more worrisome, as a matter of fact, in the international sphere where they are under far less oversight.

The reason that they are doing that, at least according to their own statements, is that they fear technological obsolescence of the movement of letter mail, and they feel that they should be allowed to be competitive in areas which are also served by the private sector.

Quite frankly, we find no compelling public argument to support that position of the Postal Service. It is hard for me to fathom why it is in the public interest. The Postal Service is exempt from anti-trust regulation, is exempt from most tort claims—at least according to them that they are—is represented by taxpayer-funded lawyers, does not pay any sales, excise or property taxes, is exempt from zoning regulations, does not buy license plates for their cars or their trucks, has no zoning restrictions on it and, in fact, only pays parking tickets if it voluntarily agrees to do so. With the Postal Service enjoying all of those advantages—not to mention the fact that for every dollar of profit that we return to our shareholders, we pay, at the moment, about 41 cents out of every dollar to the Federal Government—we can't for the life of us find any compelling public-interest argument for the Postal Service to be able to diversify into the goods movement sector.

But having said that, there is a very large private interest in the Postal Service becoming something that has a viable mission in the 21st century, and the political realities of that are so stark that we believe that H.R. 22 is a good compromise, dividing the Postal Service's operations into the sector which benefits from all of those advantages that I just listed—and many more, plus the monopoly rents that they can command by virtue of their letter monopoly—and a competitive sector which has the appropriate controls, and opportunities and risks that our companies take in the marketplace every day.

So on that basis, we think H.R. 22 is a well thought out first step toward the commercial operations of the Postal Service becoming privatized. It recognizes the private interests of postal workers and the interests of the people who have come to depend on the mails, but also recognizes the realities of the world economy and the realities of the marketplace for the 21st century.

One of the areas of particular concern, before I conclude my remarks and turn it over to Mr. Kelly, is the Postal Service's forays into the international marketplace. As you know from the Postal Service's own figures, they lose money. In fact, as well reported, they lost a considerable amount of money. That money has been paid for by the taxpayers of the United States in lost income taxes not paid by the commercial transportation companies that would have handled that traffic or by the first class letter mailers who would have enjoyed lower rates for the movement of their traffic had it not been for these efforts of the Postal Service to get involved in those sectors.

In that sector, in particular, they are not under the same control elements and auspices of the Postal Rate Commission, as you know. And I think Jim Kelly, who has been very vocal about this and compared some of the rates being charged in the international sector compared to the domestic sector, makes a very, very compelling case as to how this is neither desirable nor fair.

I think, with that, I will stop and, hopefully, I have given you the very broad perspective of our view on the Postal Service's situation and the legislation itself.

[The prepared statement of Mr. Smith follows:]

Hearings before the
Subcommittee on the Postal Service
of the Committee on Government Reform And Oversight
U.S. House of Representatives on
H.R. 22, The Postal Modernization Act of 1999
March 4, 1999

Statement of Frederick W. Smith
Chairman, President, and Chief Executive Officer
FDX Corporation

H.R. 22, the Postal Modernization Act of 1999, is the most substantial and thoughtful proposal to reform the postal laws of the United States in 25 years or more. H.R. 22 charts a sound and balanced course for modernization and reform of U.S. postal law. FDX Corporation, including its subsidiaries Federal Express and RPS, will support enactment of H.R. 22 into law provided that Congress refrains from amendments that undermine the careful balance struck in the proposal.

At the outset, I would like to commend the Subcommittee, and especially Chairman McHugh and his staff, for their attention to public service in the best sense. Two and a half years ago, I testified on an earlier version of H.R. 22. In the intervening period, the Subcommittee has diligently sifted arguments and proposals advanced from many different points of view and incorporated into the bill not the views of the largest or loudest partisans, but the ideas that would, in the view of the Subcommittee, advance the public interest. H.R. 22 is a qualitatively more sophisticated bill than its earlier incarnation. This patient work has proceeded steadily even though, in all this time, "postal reform" has not once been featured on the Sunday talk shows. Balanced, nonpartisan postal reform may not be the stuff of political glory, but it is the sort of legislative work that will earn the long term gratitude of the delivery services sector and the American people.

SHOULD THE POSTAL SERVICE COMPETE WITH PRIVATE COMPANIES?

Critics of H.R. 22 have argued that a government agency like the Postal Service should not be allowed to compete with private industry. Philosophically, I agree with these critics. But, as events of the last six months—indeed, the last few days—have graphically demonstrated, at some point philosophy must yield to reality. The major post offices of the world, including the U.S. Postal Service, are in the process of launching a massive commercial attack on private industry. Commercial developments are threatening to overwhelm the incremental reforms of H.R. 22. In the foreseeable future, governments will confront still more fundamental policy choices in the postal field. If enacted promptly, I believe that H.R. 22 will provide

Congress with a rational basis for further decisions. If not, in my judgement, Congress will have to move directly to more radical, and probably less well considered, legislation.

Basically, the only proper justification for a government Postal Service is to act as a provider of last resort for necessary public postal services that would otherwise be unavailable from the private market. A government Postal Service—which does not need to make a profit, does not answer to shareholders, loads its fixed costs on a legal monopoly, and cannot go out of business—behaves so differently from private competitors that it distorts the entire market. These dangers are compounded by the perverse tendency of the Postal Service to use governmental powers for commercial ends. The Postal Service has, for example, issued regulations which expand the definition of the postal monopoly far beyond anything Congress intended. As representative of the United States at the Universal Postal Union, the Postal Service has negotiated treaties that advance its commercial interests rather than those of the United States as a whole.

In the beginning of the Republic, the Post Office Department was established on exactly this basis. Given the undeveloped state of the national transportation system and financial markets, only the federal government could establish a national Post Office for distribution of letters and newspapers. In the early 1900s, the Post Office's mission was expanded to provide a rural parcel service that the private market was unable to provide.

Today, however, the Postal Service is inexorably losing its status as a provider of last resort. The financial and operational core of the Postal Service—the monopoly over the carriage and delivery of letters—will one day dissolve in a technological mist. Senders of letters and documents will have multiple alternatives to the Postal Service for delivery of their correspondence.

As competitive services replace the public services of the Postal Service, Congress must choose between two policy options. Either the Postal Service must be wound down in an orderly manner as competitors are able to take over its functions or the Postal Service must be allowed, *and required*, to compete on terms that are identical to those faced by private competitors.

Closing down the Postal Service, like any other government agency that has outlived its usefulness, is an option that ought to be considered seriously. However, the practical and political problems would be formidable. No matter how quickly technology and competitive alternatives advance, America will be dependent on the Postal Service for some period of time. Managing an organization the size of the Postal Service through a long period of decline and diminution of function, while maintaining quality of service, be an extremely difficult task.

The alternative is to require the Postal Service to compete on a level playing field whenever it competes with private companies. If and when the Postal Service finds itself in competition in all aspects of its business, then it must, in all aspects of its business, face the same conditions as private competitors. In other words, it must become a private company. There will no longer be any public policy justification for a postal monopoly law or a governmentally owned and operated Postal Service. As in the aviation industry, minor market failures will be addressed by government contracts to remedy specific problems.

H.R. 22 moves towards clarification of these options. H.R. 22 restructures the Postal Service into two fundamental divisions: non-competitive and competitive. On the one hand, H.R. 22 preserves the ability of the Postal Service to perform its remaining non-competitive, public service missions. On the other hand, H.R. 22 gives the Postal Service freedom to offer competitive products on even terms with private industry. Accounts for the non-competitive and competitive products must be kept separately. In addition, non-postal products and joint ventures must be provided through a separate Corporation. Eventually, I believe, this discipline of structural separation should be extended to all competitive products.

In the foreseeable future, there will be no escaping a fundamental decision on the fate of Postal Service. The clear distinction between non-competitive and competitive products established by H.R. 22 will lay the proper groundwork for this decision. If, after a few years, it turns out that the Postal Service has learned to compete fairly and successfully, then Congress should move towards complete privatization and demonopolization. If not, then Congress can, with a clear conscience, act to spin off the Corporation and restrict the Postal Service to a shrinking pool of noncompetitive functions. In the long term, we can live with either outcome.

What we cannot live with is the current situation. The center of gravity of the Postal Service is shifting more and more towards a competitive posture, yet the Postal Service, operating under a 1970 law, is not required to abide by the same laws as private companies. There are no clear rules as to what businesses the Postal Service can enter or how its competitive ventures are to be financed. Only a couple of days ago, the Postal Service announced that it would provide international express service in conjunction with the German Post Office through a subsidiary, DHL, bought largely with public assets. In this way, the Postal Service is able to piggyback on the anticompetitive accomplishments of foreign post offices. Faced with such a situation, the Postal Rate Commission does not begin to have the tools to enforce even the vague rules that do exist.

H.R. 22 will clarify the rules for now and lays the groundwork for a more fundamental decision on the long term final fate of the Postal Service. In my judgement, H.R. 22 is the right postal bill at this time.

UNIVERSAL POSTAL SERVICE

Postal Service competition with private companies is a two-sided coin. For many, the principal issue is not the difficulties faced by private companies but the threat that competition may pose to the Postal Service's ability to maintain universal postal service.

Let me be clear. I support universal postal service. Every citizen in every part of the Nation should have access to basic, affordable postal service. I do not want to see stamp prices increased unnecessarily. I recognize and respect the spirit of public service that motivates men and women in the Postal Service. "Should the United States assure universal postal service?" is not an issue so far as I am concerned. But "What is the most efficient way for the United States to guarantee a level of universal postal service consistent with our national needs?" is a legitimate question that proponents of universal postal service must address seriously and quantitatively, with more than knee-jerk calls for monopoly and postal privilege.

The role of the postal monopoly in the provision of universal postal service is frequently misunderstood. It is often argued that anything that allows the Postal Service to expand its business in a given market is desirable so long as revenues cover incremental costs and earn an additional dollar. This dollar, it is said, reduces the overhead costs borne by first class mailers. This logic would support extension of the Postal Service's monopoly into any business activity in which incremental costs are less than total costs. For example, granting the Postal Service a monopoly over air freight services could, by this reasoning, reduce the price of a first class stamp by several cents.

What's wrong with logic? What's wrong is that a monopoly not only generates economies of scale, it also breeds inflated costs, inefficiency, and lack of innovation. I can tell you from personal experience that no one in his right mind would suggest that the United States would have better or cheaper or more universal express service today if the Postal Service had succeeded in extending its monopoly to include express services in the 1970s. Suppose the Postal Service had participated in the early express business by pricing at marginal costs and loading overhead costs on to monopoly mailers? The result would have been to discourage investment in the development of the express industry. Either way, substantial Postal Service involvement would have retarded evolution of our current, universal express network. In regard to more traditional postal services, as well, a recent study by economists at the Postal Rate Commission suggests that inefficiencies due to the postal monopoly exceed economies of scale by several billions of dollars. While reasonable persons can dispute the exact figures, no one can deny that a postal monopoly implies huge costs as well as benefits. The truth is that the postal monopoly has probably *increased*, not decreased, the cost of universal postal service in the United States.

A closely related issue is the cost of the Postal Service's universal service obligations. Here, too, there are many misunderstandings. Economic studies show that the cost of rural postal service is not much greater than the cost of urban postal service. Even if there were no legal mandate, the Postal Service would continue to serve all addresses in the United States, the same as Federal Express. The major costs of universal service lie elsewhere.

In place of misunderstanding and groundless assumptions, H.R. 22 offers several measures that would begin to develop necessary data and clear objectives.

Although the costs of legally mandated universal postal service are often said to justify the extra revenues supposedly generated by the postal monopoly, in fact no one knows the magnitude of such costs. Changing technology may or may not have the effect of increasing the cost of universal postal service. Lack of data has bedeviled postal policy discussions for decades. H.R. 22 would shed needed light on this topic. For the first time, the Postal Regulatory Commission will provide an annual estimate of the costs of universal service.

Another often overlooked element of universal service is the quality of service. The proper question is not whether postage rates are high or low, but whether the mailer is getting good value for his money. H.R. 22 will require the Postal Service to provide the Postal Regulatory Commission with regular reports on the quality of noncompetitive services. This, too, is a distinct advance over current law.

Cost and quality of service come together in the question, "What level of universal postal service should the government guarantee in the future?" As we develop more and more ways to communicate, this is a policy question that deserves more careful consideration. In this respect, as well, H.R. 22 makes a contribution by requiring the Postal Service to begin the process of identifying specifically what level of universal postal service is suited to national needs.

In sum, H.R. 22 will move us towards a more efficient, more cost-effective universal postal service, better tailored to the needs of the Nation. These measures are not only desirable; they are overdue.

FIREWALLS: THE LYNCHPIN OF H.R. 22

Given the bill's dual focus on the rules of competition and protection of universal service, the core reform of H.R. 22 is the division between noncompetitive and competitive products. This division provides the framework for other reforms, including all provisions giving the Postal Service greater commercial freedom in competitive markets. Division is enforced by what the Chairman has dubbed H.R. 22's "firewalls." The firewalls consist of several types of provisions:

- reliance upon objective factual criteria (degree of effective competition), administered by the Postal Regulatory Commission, to define noncompetitive and competitive categories;
- separation of accounts, both operating accounts and capital assets;
- requirement of an allocation of common overhead costs proportional to the distribution of attributable costs (equal cost coverage rule);
- structural separation for Postal Service participation in joint ventures and non-postal markets;
- an end to legal privileges favoring the Postal Service in the provision of competitive products.

Without strong firewalls, H.R. 22 is a dead letter. Mailers will never accept greater commercial freedom for the Postal Service if they will be forced to underwrite the Postal Service's competitive adventures. Competitors—including not only companies like Federal Express but also newspapers, messenger companies, and private post offices—will oppose H.R. 22 unless assured that the Postal Service's competitive activities will not derive substantial financial, legal, or commercial benefits from its noncompetitive activities. Just as importantly, H.R. 22 will fail as a modernization measure if the Postal Service is not required to operate with true private sector efficiency. Subsidized Postal Service participation into competitive markets will not raise the Postal Service's operations to the level of private enterprise; it will bring down the competitive market to the false economies of the Postal Service.

I cannot emphasize too strongly the importance of these firewalls in our evaluation of H.R. 22.

Because of our concern for the integrity of the firewalls, we cannot support a number of amendments proposed by the Postal Service. For example, we oppose amendments which assign various products to the competitive category regardless of whether they in fact face effective competition. Similarly, we cannot support amendments that would give the Postal Service exclusive authority to initiate re-assignment of noncompetitive products to the competitive category. Both types of amendments are inconsistent with firewalls erected by H.R. 22. Commercial freedom for the Postal Service should be coterminous with effective marketplace discipline.

Still more damaging to the firewall protections is the Postal Service amendment that would replace the Competitive Products Fund with an uncertain and unpredictable alternative accounting scheme. To implement this new accounting scheme, the Postal Service proposes to scrap accounting practices worked out by the

Postal Rate Commission over thirty years and devise a new method for assigning operational costs and revenues. Separation of accounts would be part of a larger exercise to assure the Postal Service's ability to obtain financing for competitive products. For five years, the Postal Service proposes to continue use of the full faith and credit of the United States to borrow money to compete against private companies. Lemming Express may support additional commercial flexibility for the Postal Service's competitive activities under such circumstances, but Federal Express will not.

Another Postal Service amendment that would remove a firewall element crucial to the bill is the proposal to sunset the equal cost coverage rule after five years. The Postal Service says the equal cost coverage rule will be "unnecessary" after five years. I cannot understand this argument. Manifestly, this principle will remain a critical element of postal policy so long as the Postal Service has the ability to shift overhead costs of competitive products on to users of noncompetitive products. The Postal Service also suggests that the equal cost coverage test might become more difficult to satisfy if bill payment migrates to email. While this possibility supports a provision, already in H.R. 22, authorizing the Postal Regulatory Commission to adjust application of the equal cost coverage rule for special circumstances, it does not in any way justify sunseting the rule itself.

In sum, Postal Service amendments which attack the firewalls in H.R. 22 would loose a government-subsidized monster in the delivery services sector and other segments of the American economy. Rather than see creation of such a monster, we would join with those who believe that the Postal Service must be confined to noncompetitive markets and dismantled as these markets shrink.

NONCOMPETITIVE POSTAL PRODUCTS

For the foreseeable future, the bulk of Postal Service revenues will continue to be derived from markets that are noncompetitive because of legal or practical consequences of the postal monopoly. H.R. 22 proposes a basic change in the regulation of noncompetitive products with the introduction of price caps for baskets of products.

The proposed price caps would address a fundamental flaw in the 1970 act. Under current law, the Postal Service has unfettered discretion to determine the overall level of revenues to be extracted from customers who cannot choose alternative suppliers. Such unchecked monopoly power is logically absurd and detrimental to the public interest. The Postal Service has had little reason to control its costs, and postal unions have had no incentive to moderate wage demands. An independently administered system of price caps is a necessary reform.

Details of the price cap mechanism are of greater concern to other parties, so I will leave it to them to make specific comments. However, I would like to offer a couple of general observations. Price caps essentially allow the Postal Service two

types of pricing freedom. First, the Postal Service would be authorized to raise the *overall level* of postage rates within specified limits. This type of freedom has gained a substantial measure of acceptance in the mailing community. Second, the Postal Service would be allowed to adjust rates of individual products, thus "de-averaging" or "re-balancing" the distribution of overhead costs among different products. This type of freedom is much more controversial. Each mailer of noncompetitive products fears that he will pay a higher share of overhead costs and the other fellow will pay a lower share. In response to such fears, H.R. 22 limits this second type of rate flexibility with tightly drawn rate bands. The Postal Service has proposed amendments that would allow it greater flexibility to re-balance tariffs. While I suspect that the Postal Service may need somewhat greater flexibility than permitted in H.R. 22, the politically feasible path probably lies closer to H.R. 22 than the Postal Service's proposal.

At the same time, limiting the ability of the Postal Service to re-balance tariffs restricts its ability to adjust tariffs to reflect changes in underlying cost structures. Without such pricing flexibility, the level of overhead costs borne by individual products could drift substantially from the standards set in the baseline rate case. For this reason, the Postal Rate Commission has suggested H.R. 22 provide for cases to "realign" baseline rates. This proposal is worth serious consideration. The frequency of realignment cases might be limited to ensure that they do not become a substitute for price cap mechanisms provided in the bill.

H.R. 22 also introduces a new concept into the pricing of noncompetitive products: negotiated service agreements. Under this provision, the Postal Service will be allowed to more closely integrate its operations with major mailers and pass on a portion of the cost savings. At the same time, negotiated service agreements must be structured so other mailers will not be disadvantaged. This concept represents a major advance over the unlimited discounts contemplated in an earlier version of H.R. 22.

COMPETITIVE POSTAL PRODUCTS

H.R. 22 would grant the Postal Service essentially the same commercial freedom in the pricing of competitive postal products as enjoyed by private companies. The Postal Service would be allowed to price any product down to attributable costs. The Postal Service would be able to negotiate contracts with major customers and introduce volume discounts. In a market test of a new product, the Postal Service would not be constrained to cover attributable costs, although losses would have to be made up from competitive product revenues in the future.

Pricing freedom is not unlimited, however, any more than it is for a private company. Like a private company, the Postal Service would be free to price some competitive products more aggressively than others, but, in so doing, it would also run the risk of losing business in other competitive products whose prices would have to be raised to make up for lost contribution to overhead. If Postal Service fails to

cover overhead costs in a given year, it will be forced to make up losses in succeeding years. This is the discipline imposed by the equal cost coverage rule, a firewall provision described earlier. In administering the equal cost coverage rule, the Postal Regulatory Commission would be authorized to make allowances for intrinsic differences in the cost structures of noncompetitive and competitive products. In addition, the Commission is authorized to phase-in this requirement over five years to allow the Postal Service a fair chance to raise its efficiency to market levels. While the discipline of the equal cost coverage rule is flexible, it is also indispensable. Without it, pricing freedom for competitive products is out of the question.

As always, an important element of the regulatory framework is the mechanism for enforcing the rules. H.R. 22 provides that the Postal Regulatory Commission will annually audit the books of the Postal Service. These accounts will be available to the public in sufficient detail so that interested parties can check the Commission's conclusions. If necessary, any party, or the Commission on its own motion, can initiate a complaint proceeding which can result in an order re-setting competitive rates to lawful levels. H.R. 22 further provides that the Postal Regulatory Commission can require the Postal Service to discontinue a competitive product that persistently fails to cover attributable costs.

As I have always said, we are ready, willing, and able to compete with the Postal Service on equal terms. If the disciplines and controls provided in H.R. 22 are not significantly weakened, we can accept the commercial freedom for the Postal Service's competitive postal products granted by H.R. 22. My only suggestion in this area is to ask the Subcommittee to reconsider the standards which the Postal Regulatory Commission would apply in re-setting rates after a complaint proceeding. In our view, these standards are not sufficiently clear, so we have proposed a technical amendment on this point.

EQUAL APPLICATION OF LAWS TO COMPETITIVE PRODUCTS

H.R. 22 takes great strides in advancing the simple, but fundamental principle that the Postal Service should be subject to the same laws as everyone else when it participates in competitive markets. In brief, the Postal Service's competitive products would be subject to antitrust law, tort law, unfair competition law, and zoning law in the same manner as a private company, and the Department of Justice is directed to report on other differences in legal treatment. I strongly support these reforms.

In this part of my testimony, I would like to touch briefly on the application of this principle to three areas highlighted in my 1996 testimony: mailbox access, vehicular licenses, and customs laws.

Mailbox access. Under the mail box access rule (18 U.S.C. §1725), private companies are prohibited from placing items in curbside mailboxes even though a

GAO study has found that a clear majority of Americans (58 percent) believe this restriction should not apply to companies like Federal Express. This rule is the product of Depression-era concerns. In the mid-1960s, the Post Office announced it would henceforth deliver only to curbside boxes in new residential areas, citing studies showing that curbside delivery was half as expensive as delivery to the door. This policy has greatly increased the commercial importance of the mailbox access rule. Today, more than 70 percent of residential deliveries are made to curbside mailboxes, cluster boxes, apartment boxes, and similar Postal Service-only receptacles.

In 1996, I urged the Subcommittee to repeal the restriction on mailbox access. Unfortunately, the Subcommittee concluded that even a limited experiment in opening the mailbox access was too controversial to include in H.R. 22. Without seeking to revisit that decision in this bill, I would ask the Subcommittee to consider the fairness of allowing the Postal Service to use the mailbox system for delivery of competitive products while denying this right to competitors. After all, the Nation's system of mailboxes was built and paid for by mail recipients, not by the Postal Service. Unless the law on mailbox access applies equally to all competitive products, the law will perpetuate a tremendous bias in favor of the Postal Service in lawfully competitive markets. I urge the Subcommittee to provide that the mailbox access rule applies equally to all competitive products.

Vehicular license fees. H.R. 22 provides that the Postal Service shall comply with Federal and State laws regulating the operation of vehicles if such vehicles "are primarily and regularly used for the transport or delivery" of competitive products. In reality, this vehicle-by-vehicle test means that the Postal Service will almost always escape license fees. In contrast, another provision of H.R. 22 imposes tort liability on the Postal Service vehicles depending on the proportion of non-monopoly mail being carried by the vehicle at the time of an accident. In one of its amendments, the Postal Service argues that pro-rata application of tort liability is impractical under such circumstances. We agree with the Postal Service on this point. By the same token, however, pro-rata application should be used wherever it is practical. In the case of license fees, it would be perfectly feasible to require the Postal Service to pay license fees based on the overall proportion of competitive products delivered by its vehicular fleet in a given State. I urge the Subcommittee to consider these practical modifications to the principle of equal application of the laws.

Customs laws. Customs laws are the single biggest impediment to the development of international trade. H.R. 22 provides that the Postal Service, in the provision of competitive products, may not take advantage of discriminatory foreign customs procedures designed exclusively for postal shipments. Implementation of this provision is delayed for five years, however, to avoid imposing burdens on U.S. shippers who have invested in Postal Service products that make use of foreign customs preferences. I accept the fairness of a five-year grace period for existing products, but I do not think the Postal Service should be able to take advantage of

this grace period to develop *new* international products and services that take advantage of such discriminatory foreign customs procedures. Therefore, I ask the Subcommittee to consider limiting this grace period provision to *existing* international postal services.

IMPARTIAL ADMINISTRATION OF THE LAWS

Closely related to the matter of equal application of the laws is the problem of impartial administration of the laws. Not only should the Postal Service, in its competitive activities, play by the same rules as everyone else, but the government should apply the rules equally and impartially to all. This obviously will not be the case if the Postal Service itself is entrusted with exercising governmental authority. H.R. 22 addresses this issue in two important areas.

First, H.R. 22 divests the Postal Service of authority to issue regulations administering the postal monopoly. Current administrative suspensions of the postal monopoly are preserved by statute. I strongly support these necessary reforms. Not only will they give legal certainty to the scope of the postal monopoly, but they will also go a long way towards improving relations between the Postal Service and private operators. The Postal Service has proposed an amendment that would, among other things, resurrect the Postal Service's rulemaking authority over the postal monopoly. Although the Postal Service has assured us that this was an unintended consequence of this amendment, we urge the Subcommittee to scrutinize this amendment with extreme care.

Another provision of H.R. 22 would generally bar the Postal Service from competing in an area that it regulates or regulating an area in which it competes. This principle is very important and must be retained. We do not object to a Postal Service amendment that would, as we understand it, require the Postal Regulatory Commission to follow antitrust precedents developed by the Department of Justice and Federal Trade Commission rather than concocting its own unique brand of "postal antitrust" law.

POSTAL MONOPOLY

H.R. 22 would limit the scope of the postal monopoly to letters transmitted for less than six times the basic stamp price, that is, less than \$1.98 at today's stamp price. In addition, letters weighing more than 12.5 ounces could be carried out of the mail even if priced less than six times the stamp price. This approach to limiting the postal monopoly is similar to that adopted in many countries, including the European Union, although it is not as pro-competitive as reforms adopted by countries such as Sweden, New Zealand, and Germany, which have abolished their postal monopolies altogether (in 2003 in the case of Germany). The practical effect of H.R. 22's new limits on the postal monopoly will be to repeal the monopoly over two-pound Priority Mail shipments that can legitimately be considered "letters," less than 4 percent of total Postal Service revenue.

While I support these provisions of H.R. 22, I would go further. Over the long run, the only tonic that can enhance the vigor of the Postal Service is competition, and I would recommend a larger dose. While H.R. 22 is clearly moving in the right direction, I encourage the Subcommittee to consider the wisdom of adding more stringent limits on the postal monopoly, to be phased in after a few years. For example, a price limit of double the stamp rate would still protect more than a third of Postal Service revenue from competition. Given the pace of change, such a prescription is not too strong medicine for the Postal Service.

In addition, we have submitted to the Subcommittee a number of technical amendments to the postal monopoly provisions of H.R. 22. These will clarify without changing the intent of H.R. 22. For example, H.R. 22 plainly intends that bulk outward international mail should be considered outside the postal monopoly because such mail is placed in the competitive category. Nonetheless, no provision in H.R. 22 actually permits private carriage of such mail. We have suggested an amendment that would do so. Similarly, although a provision in H.R. 22 provides for grandfathering the current administrative suspensions of the postal monopoly, in many cases the precise legal results of this provision will be unclear. We therefore suggest that the Postal Regulatory Commission issue regulations that would set out specifically the scope of the administrative suspensions grandfathered by H.R. 22. Given the extreme importance of the postal monopoly provisions for all parties, I urge the Subcommittee to consider these technical amendments carefully.

PRIVATE LAW CORPORATION

H.R. 22 authorizes the Postal Service to establish a private law Corporation. The Corporation can offer non-postal products as well as postal products and engage in joint ventures with private companies. Financing for the Corporation would be limited to the funds and assets of the Corporation itself and the funds and assets of the Competitive Products Fund, as well as such money as the Corporation can borrow on its own credit or attract in the form of contributions from joint venture partners and new shareholders (in subsidiaries). I support this provision of H.R. 22 because it will place clear and reasonable restrictions on the Postal Service's ability to use public assets and monopoly revenues to gain a competitive edge in such markets.

For the Postal Service, the Corporation offers an alternative organizational structure for providing competitive products. Because of structural separation, the Corporation will also allow the Postal Service to escape the detailed oversight by the Postal Regulatory Commission necessitated by joint costs. The Postal Service will be able to move some competitive postal products to the Corporation, although the inherent advantages of the Corporation may be offset by losses in economies of scale. If the Corporation is commercially successful, its enhanced value will improve the balance sheet of the Competitive Products Fund. If it is unsuccessful, it should be allowed to fail like any other private company.

As a means of preventing cross-subsidy and other distortions due to the postal monopoly, structural separation is manifestly superior to accounting separation of joint costs. As proposed, H.R. 22 requires the Postal Service to carry on new activities, which are separable from traditional postal activities, in a structurally separate Corporation. Indeed, after a suitable transition period, the Postal Service should be required to spin off its competitive postal products to the Corporation to the maximum feasible extent. Structural separation should be the rule, rather than the exception, for all competitive postal products.

Another benefit of the manner in which H.R. 22 establishes the Corporation is to serve as an international precedent. In Europe, the European Commission has utterly failed to devise the sort of standards set out in H.R. 22. European post offices have freely sold public assets, like real estate, to underwrite purchases of private companies like DHL. A clear U.S. policy will help us to make the case for adoption of similar rules in Europe.

Some critics of the Corporation have argued that it should be deleted from H.R. 22 because it allows the Postal Service to enter non-traditional businesses. I believe these critics are missing the point. The Postal Service has already begun to experiment with non-traditional postal products, joint ventures, and non-postal products. In other developed countries, post offices have gone further down this road than the Postal Service. If Congress is not ready to stop this trend in its tracks, then it is highly desirable to require that such activities be placed in a separate corporate structure. After a few years, Congress will have a rationale basis for deciding whether the Postal Service can and should be allowed to compete like a normal company. If Congress decides the Postal Service should be divested of such activities, a corporate form will facilitate sale.

Plainly, the Corporation should not serve as an end run around the restrictions of the Competitive Products Fund and the equal cost coverage rule. If the Postal Service places assets into the Corporation, these assets must be independently evaluated and the Competitive Products Fund should receive payment for such assets in the form of bonds or stock issued by the Corporation. In addition, the Postal Regulatory Commission will have to adjust the application of the equal cost coverage rule if competitive postal products are shifted to the Corporation. Similarly, the pricing of transactions between the Postal Service and the Corporation will have to be subject to scrutiny by the Postal Regulatory Commission.

It is certainly true, as pointed out by the Postal Rate Commission, that the Corporation should not be able to "play" with its assets without financial consequence. The law must never lose sight of the fact that these assets belong to the people of the United States, not to the Postal Service itself. Accounting rules should be devised to make sure that the Corporation is motivated to act like a normal, profit-oriented company and the Postal Service is barred from shifting monopoly rents to the Corporation. Perhaps Congress should provide for the sale of a substantial portion of the Corporation to the public within a definite time frame. Public

ownership would provide an independent evaluation of the value of the Corporation and ensure that the Corporation's Board of Directors makes realistic business decisions since "real" money of "real" investors will be at stake. This may be the only way to ensure that the Corporation acts like a normal company. At a minimum, Congress should provide for a comprehensive review of the operations of the Corporation after a fixed time period. This review should include appraisals by the Treasury Department, the Department of Justice, and the Postal Regulatory Commission.

ROLE OF THE BOARD OF GOVERNORS

H.R. 22 proposes to redesignate the Board of Governors as the Board of the Directors "to convey the business responsibility of the Directors for ensuring effective and efficient operations of the Service on behalf of the American public. "H.R. 22 also requires that new Directors of the Postal Service be chosen on basis of experience in managing organizations or corporations "similar in size in scope to the Postal Service." At the same time, H.R. 22 retains the statutory duty of the Board to *"represent the public interest generally."*

The proposed changes in the title and qualifications for the Board of Governors highlight the inherent conflict in the mission of the Postal Service. Is the Postal Service supposed to pursue its commercial self interest or the general welfare? As the Postal Service becomes an ever more competitive entity, this conflict is exacerbated. Worse, it may become blurred; public interest responsibilities may be invoked to justify commercial decisions. For these reasons, I suggest that the Subcommittee consider clarifying the role of the Board by making its primary focus *either* management of the commercial interests of the Postal Service *or* representation of the public interest, not both.

INTERNATIONAL POSTAL POLICY

H.R. 22 would correct a basic flaw in the 1970 act by submitting international mail to the same regulatory oversight as domestic mail. The reasons which require regulatory oversight of domestic mail—protection against abuse of monopoly power and control of predatory behavior—apply equally to international mail. I strongly support this reform.

H.R. 22 would also vest authority for international postal policy in the Department of State and set pro-competitive objectives for the Department of State to pursue. This provision would extend and clarify amendments to the postal law adopted last fall, and I support it.

Since last fall, Ambassador Michael Southwick and his staff in the International Organizations office at the Department of State have worked diligently to master complex issues quickly. Urgency is required because the Universal Postal Union (UPU) convenes a general congress in August in Beijing to negotiate the legal

framework for international postal services during the period 2001 to 2005. The deadline has already passed for submitting certain types of proposals for consideration at the Beijing Congress. Under Ambassador Southwick's leadership, the United States has recently proposed that the UPU convene an Extraordinary Congress in 2001 to reorganize the organization along commercially neutral lines. This is an extremely important and responsible initiative for which the Department of State deserves commendation.

On the other hand, the Department of State has failed to develop procedures to open development of U.S. policy to all interested parties, including the Postal Service, private carriers, and mailer groups. The Postal Service continues to enjoy exclusive access to key policy proposals and policymaking meetings. I am hopeful that the Department of State will move rapidly to reform these procedures. If it does not, the United States Government will not have the benefit of a public dialog on possible U.S. proposals to amend the Universal Postal Convention. The deadline for submission of such proposals is April 22 (with the co-sponsorship of two other countries). I urge the Subcommittee to oversee these developments with vigilance and, if necessary, to add to H.R. 22's provisions on international postal policy to ensure that the U.S. policymaking is as open and transparent as possible.

TIMETABLE FOR IMPLEMENTATION

In one amendment, the Postal Service proposes acceleration of H.R. 22's reforms by doing away with the baseline rate case and using instead rates from the last general rate case.

I agree with the Postal Service that the reforms of H.R. 22 can be and should be introduced more quickly, and I urge the Subcommittee to look into ways to do so. Most reforms can take effect when baseline rates are effective and the Competitive Products Fund is established. Whether or not a baseline rate case is needed immediately depends in large part on whether realignment cases are allowed. A baseline rate case for international rates will be needed in any case since these rates have never been reviewed by the Postal Rate Commission.

CONCLUSION

With the changes I have proposed, H.R. 22 represents a very sound approach to necessary modernization of the Nation's postal laws. I hope that you will give serious consideration to our suggestions for improving the bill.

Thank you for your consideration of the views of FDX Corporation.

Mr. MCHUGH. Thank you, sir. You have indeed. I normally don't recommend reading to anyone, but anyone who might be interested in this process, the testimony that you have submitted is among the more complex and thoughtful that we have had, and I would recommend it to anyone who would care to review it.

That isn't only my interpretation because you are generally supportive, although it probably helped. [Laughter.]

I would now be happy and delighted to yield to our next witness, Mr. James Kelly, who is chairman and chief executive officer of United Parcel Service. As I said earlier, sir, we are delighted and honored that you are with us. Without further ado, let me yield to you and our attention is yours.

Mr. KELLY. Thank you very much, Mr. Chairman. It is my pleasure to be here, and good afternoon to members of the subcommittee.

UPS was founded in 1907 as the world's largest express carrier and package delivery company—

Mr. MCHUGH. Excuse me, Mr. Kelly. Would you pull the microphone a little bit closer to you, please. Thank you.

Mr. KELLY [continuing]. Serving more than 200 countries and territories around the world.

There is no single issue of greater importance to the future of UPS and our 330,000 employees and owners than postal reform, and thank you for inviting me here today to share our views.

I would like to take a moment to thank you, Mr. Chairman, for your tireless work and patience in grappling with what must often seem like a thankless task. You have always been willing to listen to both sides of this controversial issue, and your hard work and leadership over the past few years have helped to define many of the problems and challenges at hand and to shape possible solutions.

This is an extremely complex issue with profound ramifications for all Postal customers, as well as private competitors, like UPS. We have listened to all of the arguments made by the Postal Service that they need even greater flexibility over their prices to compete in the marketplace. They say they must maintain their monopoly on letter mail and remove what little oversight they now observe. Otherwise, they say they will not be able to deliver mail at affordable prices, stamp prices will go sky high, universal service will die, rural post offices will close and the doctrine of a service to "bind the Nation together" will die. And we all know none of this is true.

Mr. Chairman, the logic leads us in the wrong direction. It perpetuates the fundamental problem with the Postal Service as a privileged competitor to private business and a Government agency.

Let me pose two fundamental questions that goes to the heart of this debate:

What is the role of this Government agency and is the proper role of the Government to leverage a monopoly power to compete with private business?

You have stated the objective of reform should be to enhance the core mission of providing universal letter-mail services at uniform, affordable prices, and we agree. Unfortunately, we believe, in its

present form, significant portions of H.R. 22 would create even greater danger of monopoly abuse by the Postal Service.

Reform should not grant the Postal Service additional freedoms to abuse its monopoly to compete with the private sector. Yet, that is exactly what we believe the current bill would do. That is not the role Congress intends for a Government-granted monopoly.

The Postal Service is currently operating under a hybrid status where it is neither subject to the same controls as a Government agency nor is it under the same discipline or obligations that private businesses face. The Postal Service enjoys a host of exemptions from regulations such as taxes, licensing requirements, zoning regulations and so on. The result of this structure is a Postal Service that has abandoned its focus of providing superior first-class service for all Americans. This is all in efforts to garner market share from private-sector competitors, through abuses of its monopoly power, under the guise of protecting universal service in a changing marketplace.

For the past decade or so, the Postal Service has ventured into new markets and products never envisioned by Congress when reforming the Postal Service in 1970. The Postal Service is engaged in predatory competition by using revenues from captive, first class monopoly customers and taking every advantage of its Government status to undercut prices of private-sector competitors.

Last month, the postmaster general testified before this committee about the threat of the highly commercialized and capitalized foreign postal administrations entering the U.S. market. Mr. Henderson stated that the Postal Service would not have the ability to cut deals with foreign postal administrations and offer products priced below competitors, such as UPS and Federal Express.

On Monday, the Postal Service announced an alliance with DHL Worldwide. They will offer a 2-day guaranteed service between the United States and Europe. The price for this service is significantly less than the prices charged by Federal Express, UPS, or DHL's own branded products. I ask the committee how can this be possible? Apparently, despite the rhetoric, the Postal Service isn't that terrified of foreign postal administrations entering the U.S. market, as DHL is owned, in part, by the Deutsche Post AG.

Should we allow the Postal Service greater flexibility to make such arrangements with foreign governments or is it time to reign them in? We believe it is the latter. It is time to have this Government agency refocus on its primary mission of providing superior universal letter mail delivery.

Absent the elimination of the monopoly, Congress should, at a minimum, strengthen the Postal Rate Commission to increase the Postal Service's accountability to consumers and taxpayers. Currently, the PRC does not have all of the basic tools to get information it needs from the Postal Service to make informed and rational decisions.

In the international arena, the PRC has no jurisdiction, and the Postal Service has total freedom to set at any rate and service.

Again, I ask what is the role of this Government agency? The PRC should be granted subpoena power and the authority to make final binding decisions on all postal rates, including full jurisdiction over international rates. And to encourage cost efficiency of the

Postal Service, the Commission should be given authority over the Postal Service's revenue requirement. As long as the Postal Service maintains a Government-granted monopoly and is in direct competition with the private sector, these short-term basic reforms are needed to help provide consumers, taxpayers and private competitors with the accountability Americans expect of a \$60 billion Government agency.

No monopoly should have the unchecked authority the Postal Service is seeking. These reforms will also help simplify and streamline the rate-setting process. A stronger system of accountability will be an important first step in whatever long-term reforms come to pass.

Again, I thank the committee for your attention on this very important matter and for listening to UPS' views today and in the past. I certainly welcome any questions that you may have.

[The prepared statement of Mr. Kelly follows:]

D R A F T
(As of February 25, 1999)

**STATEMENT OF JAMES P. KELLY,
CHAIRMAN, UNITED PARCEL SERVICE**

March 4, 1999

**Before the Subcommittee on the Postal Service
Committee on Government Reform
United States House of Representatives**

Good afternoon, Mr. Chairman, Members of the Subcommittee. I am Jim Kelly -- Chairman and CEO of United Parcel Service. UPS was founded in 1907 and is the world's largest express carrier and package delivery company, serving more than 200 countries and territories around the world. There is no single issue of greater importance to the future of UPS and our 330,000 employees and owners than postal reform. Thank you for inviting me to share our views here today.

I would like to take a moment to thank you, Mr. Chairman, for your tireless work and patience in grappling with what must often seem a thankless task. You have always been willing to listen to all sides of this controversial issue. Your hard work and leadership these past few years have helped to define many of the problems and challenges at hand and to shape possible solutions.

This is an extremely complex issue, with profound ramifications for all postal customers as well as private competitors like UPS. We have all listened to the arguments made by the Postal Service that they need even greater flexibility over their prices to

compete in the marketplace. They say they must maintain their monopoly on letter mail and remove what little oversight they now must observe. Otherwise, they say they will not be able to deliver the mail at affordable prices. Stamp prices will go sky high, they say. Universal service will die, they say. Rural post offices will close, they say. The doctrine of a service "to bind the nation together" will die, they say

Mr. Chairman, this logic leads us in the wrong direction. It perpetuates the fundamental problem with the Postal Service as a privileged competitor to private business and a government agency. Let me pose two fundamental questions that go to the heart of this debate:

- 1) "What is the role of this government agency?"
- 2) "Is it the proper role of the government to leverage a monopoly power to compete with private business?"

You have stated that the objective of reform should be to enhance the core mission of providing universal letter-mail services at uniform, affordable rates. We agree. Unfortunately, we believe that, in its present form, significant portions of HR 22 would create even greater danger of monopoly abuse by the Postal Service.

Reform should not grant the Postal Service additional freedoms to abuse its monopoly to compete with the private sector. Yet, that is exactly what we believe the current bill would do. Is this the role that Congress intends for a government granted monopoly?

The Postal Service is currently operating under a hybrid status where it is neither subject to the same controls as a government agency nor is it under the same discipline and obligations that private businesses face. The Postal Service enjoys a host of exemptions from regulations such as taxes, licensing requirements, and zoning regulations to name a few. The result of this structure is a Postal Service that has abandoned its focus of providing superior first class service for all Americans. This is all in efforts to garner market share from private sector competitors through abuses of its monopoly under the guise of protecting universal service in a changing marketplace.

For the past decade or so, the Postal Service has ventured into new markets and products never envisioned by Congress who reformed the Postal Service in 1970. The Postal Service has engaged in direct predatory competition by using revenues from its captive first class monopoly customers and taking every advantage of its government status to undercut the prices of its private sector counterparts.

It is time to have this government agency refocus on its primary mission of providing superior universal letter-mail delivery.

Absent expiration of the monopoly, Congress should at a minimum, strengthen the Postal Rate Commission to increase the Postal Service's accountability to consumers and taxpayers. Currently, the PRC does not have all the basic tools to get the information it needs from the Postal Service to make informed and rational decisions. In

the international arena, the PRC has no jurisdiction and the Postal Service has total freedom to set any rate and service. Again, I ask -- What is the role of this government agency?

The PRC should be granted subpoena power and the authority to make final binding decisions on all postal rates, including full jurisdiction over international rates. And, to encourage cost efficiency at the Postal Service, the Commission should be given authority over the Postal Service's revenue requirement.

As long as the Postal Service maintains a government-granted monopoly and is in direct competition with the private sector, these short-term, basic reforms are needed to help provide consumers, taxpayers and private competitors with the accountability Americans expect of a *\$60 billion government agency*. No monopoly should have the unchecked authority the Postal Service is seeking. These reforms will also help simplify and streamline the rate-setting process. A stronger system of accountability will be an important first step in whatever longer-term reforms come to pass.

Again, I thank the Committee for your attention to this very important matter and for listening to our views. I welcome any questions you may have.

Mr. MCHUGH. I thank the gentleman for his comments and, as I said, his participation.

I think it is good to have two industry leaders, such as yourselves, side-by-side because the natural inclination may, in fact, be to think that you would be united from step one to step last on how this puzzle should be approached and ultimately pieced together. And as Mr. Smith said in his opening comments, that is not necessarily the case. Objectives may be the same, but perspectives along that process are not always shared exactly, and that is where we are today.

I am tempted to ask that the two of you just chat and see if one can prevail over the other, but I don't know if that would really come to any good. So let me just ask a couple of questions and then go to my colleagues.

First of all, let me say to Mr. Kelly I couldn't agree more. Clearly, one of the main reasons we are in this process is to attempt to level that playing field, to use the old cliché, that I think undeniably exists, and you mentioned a few of the examples that most trouble you and most concern you. Without trying to convince you of the merits of the bill, I would only note that the USPS, the Postal Service, venture with DHL couldn't have occurred, as it did, under H.R. 22; that, in fact, depending on how the argument came out, if it were a new competitive postal product or a new non-product as a joint venture, it would either have to go through the Competitive Products Fund, which would mean it would be under the auspices of the Postal Rate Commission, or it could only be done under the Private Law Corp., which would subject it to all of the kinds of pressures that you as private business people experience, and as Mr. Smith spoke about, taxes, the need to adhere to local zoning, land-use, and public-use regulations, and putting license plates that you actually paid for on your delivery trucks, et cetera. Also, the issues of providing, in the process of the Competitive Product Funds, the opportunity for the Postal Rate Commission to do a better job to get at the data it needs by granting it subpoena power and by requiring that products, through the equal cost coverage rule, contribute back in an equal way.

So I think we have tried to address that. Obviously, Mr. Kelly, you don't seem to think that we have gone quite far enough. You mentioned in your testimony that we need to do more.

So I just throw a general question out there. If you could have us add any one or two or three things into this area within the structure of this bill, what it might be?

Mr. KELLY. Yes, Mr. Chairman. We certainly believe that the committee is very sincere in attempting to do exactly what you just characterized, and we are working as hard as we can to help try to put our point of view to have that happen.

Certainly, we are concerned about the dual ratemaking process that is involved in—

Mr. MCHUGH. I am sorry. I didn't hear you. The what?

Mr. KELLY. Dual ratemaking process, where cost becomes less of an issue in the competitive products. We are concerned about the Postal Service's ability to discount and increase its subsidies against competitive products.

The Private Law Corp., as I understand it, it calls for them to do additional competitive products. We don't believe there is any reason for a Government agency to have to enter a competitive area. We just don't see why that exists, and we think the abuse that they use with their current monopoly should be limited and not allow them to extend that monopoly to other competitive situations.

And, certainly, we believe the PRC needs more power, needs more teeth. The Postal Service has demonstrated over the years that they need that kind of control. They have, again, today, as I read, refused to give information to the PRC in order for them to do their job properly. We believe that the PRC has to have subpoena power.

Mr. MCHUGH. But that is in the bill.

Mr. KELLY. We believe they have to have the final say in rate-setting, and there are a number of issues.

Mr. MCHUGH. Forgive me. I didn't mean to interrupt. But the subpoena power is in the bill.

Let me go back to the Private Law Corp. You would agree—and don't let me put words in your mouth—would you agree, as I think you testified to in your statement, that today, over your very understandable and strong objection, the Postal Service does, indeed, compete in just about any way it chooses with the private sector? Isn't that true?

Mr. KELLY. Well, they have certainly become more aggressive in where and how they compete with the private sector, and we believe that that should be reduced and eliminated.

Mr. MCHUGH. So the answer is, yes, they do do that. I mean, they offer phone cards, they offer mugs—

Mr. KELLY. Yes, they do.

Mr. MCHUGH. They offer ties, they offer mouse pads, they offer t-shirts—

Mr. KELLY. And what next?

Mr. MCHUGH. DHL—

Mr. KELLY. Yes, they do.

Mr. MCHUGH. Well, I don't know, but they do. So that is a given.

I guess there are two ways to meet your concern. One is to say Postal Service go to your core business, as there has been legislation introduced. Do nothing else ever.

And the other is to say, if you are going to continue in nonpostal products and compete in the private sector, you can only do it through the Private Law Corp., and that is our solution.

So I am assuming what you are saying is that you object to the Postal Service offering any kind of nonpostal product at all, ever.

Mr. KELLY. Well, long-term, that is obviously what we believe.

Mr. MCHUGH. OK. That is fine.

Mr. KELLY. I think the reality of what exists today could make the second proposition doable if, in fact, you could build the firewall thick enough and tall enough that things couldn't be tossed back and forth across. And we don't believe, and we think it has been demonstrated over the years, that they can't be prevented from doing that without stronger language.

Mr. MCHUGH. Then I would ask you, as we have asked in the past, that we need to see the language as to how to build that wall

any thicker, because we have created, and even the chairman of the Postal Rate Commission has said, in his words, "an almost perfect system." He doesn't like it. He dislikes it for other reasons, but he admits that the way in which it is done, he doesn't see how the issue of firewalls and backwash subsidies could be any better precluded.

The reason there aren't more in there is not because we are "agin 'em," but because nobody can think of them. And to preserve the Private Law Corp. and to build upon it, we are happy to do that.

Let me, with that, go to Mr. Smith because he takes a much different view, as I recall his testimony on the Private Law Corp. and the issue, and I would be interested in hearing his views.

Mr. SMITH. Mr. Chairman, you mentioned a moment ago that there, in essence, are only two solutions to this problem. The first solution would be to tell the USPS go to your core business and you are precluded from being involved in anything that a commercial enterprise can do, and the second is a track along this line.

As I said in my opening remarks, and I want to reiterate right now, if I had the power to prescribe the best public policy for the United States of America, and for that matter, for the Postal Service itself and the private sector, it would be to do the former, not the latter.

The Postal Service would be much better off if it were relegated to carrying first class letters, and small packets with a limit of, say, 2 pounds because I am very confident—and I am sure Jim will agree with me based on the extensive knowledge both of us have in terms of the structure of pickup and delivery, and sortation facilities and what have you—the overall costs for the public would go down.

On the other side of the coin, we serve every address in the United States of America with the exception of a very few points in Alaska, and I know UPS does too. The price of delivering goods to addresses should be reflective of the actual cost. If there is one thing that the last 50 years has taught the world, it is the great silliness of having governments misallocate capital and human resources. The whole problem in China and the former Eastern bloc is precisely that. People put money into ventures not because that was what the market was willing to pay or that was the most efficient allocation of resources, but because somebody was able to get the money and do that.

That is really what the Postal Service is doing. It is a significant misallocation of resources for the Postal Service to be attempting to do what they are currently doing, which is diversifying into many of those sectors, but in particular into the goods movement sector. They don't have a congressional mandate to do that. They don't have, quite frankly, the infrastructure to do that. They actually got out of that business one time because of that consideration. They are doing it to diversify.

So that would be the best public policy. But we don't think you can get there, given the political realities, and that is why we support H.R. 22 because it is the second-best alternative.

Mr. MCHUGH. I appreciate that. You have always been very clear about that as well.

Can I assume, then, because I take very seriously a man of the stature of Jim Kelly when he is concerned, and I understand that, and I have said repeatedly I am not foolish enough to think anyone who has a responsibility, as each of you do, and Mr. Kelly does, for a corporation of the magnitude and the success of UPS, to walk blindly down an alley just because I would like it. I mean, that is ridiculous, and I don't.

So I want to try to do what we can to build on the Private Law Corp. because I come down the same place you do. Regardless of how I may feel about all of the other things going on, they are going on. I don't see, quite frankly, in this Congress, in this administration, a likelihood of changing it to that reality, if that were my interest. So we are looking at the second reality.

Are you content or satisfied that the Private Law Corp., as constructed, will, indeed, do what it is intended to do, and that is to preclude, to the greatest extent possible, the kinds of abuses, and misuse and misappropriation of public finances and the public privilege that the Postal Service now enjoys in those future products?

Mr. SMITH. I would certainly hope so, Mr. Chairman. I think a lot of it depends on just how tough the PRC is in enforcing it. History shows that entities like the USPS, who are not accountable to the marketplace, per se, and to private interests, have a terrible tendency to abuse the powers that they have, and I would submit to you that Jim Kelly is absolutely right. That is what they are doing right now.

So it largely depends on just how tough that oversight system is. I would hope that, if it is not tough enough, that the legislative history of this act would be such that the private sector could come to the Congress, if there are abuses, and seek amendments.

The Postal Service has been intractable on occasions, as Jim pointed out, in providing information, in obfuscation. I think this may be just the heritage of the organization. I think it was before this committee, the Postmaster General—who may be here, I don't know—was testifying the same day Mr. Kelly and I were, and someone asked him and said, "Do you think that you are subsidized?" and he said no. Well, I got out of this room, and I talked to our folks, and I said that is the damndest thing I ever heard in my life, that the postmaster general would say that he is not subsidized when he has all of those advantages that I listed a little while ago and that are in his testimony. One of our very able lawyers said, "Well, you have got to understand that he is coming from the postal world and what that means to him is that he is not getting a direct subsidy of taxpayer funds."

Well, I think a lot of the problem here is that the marketplace that UPS and FDX work in is very brutal, and very tough, and it has a lot of penalties for making a mistake. There is a mentality inside the Postal Service that is somewhat insulated from that, and it leads to a hubris. I think that it is a real danger that they would attempt, in the interest of what they thought was their mission, to be a little bit trying to the oversight mechanisms that are in H.R. 22.

Mr. MCHUGH. Well, any system of law, of corporations, of whatever you wish to cite, is only as good as those who oversee it, I

would grant you. But we took very definitive steps, some of which came from your gentlemen's camps, as to how we can empower the PRC through subpoena power, through preapproval of negotiated service agreements, et cetera, so that that kind of thing doesn't happen. I don't know if it does or it doesn't. Obviously, you all feel very strongly, and I imagine we can find a large body of people to testify on your behalf. But you also recognize the Postal Service equally, and in an equally adamant way, denies that. So rather than trying to solve the "chicken or the egg" dispute, we tried to make sure there were no more chickens and no more eggs and fix the problem.

Mr. SMITH. And, again, Mr. Chairman, that is why we support the bill. You asked me do I think it is strong enough, and I said it depends on how strong the PRC is, and if it doesn't work, we will just have to come back.

Mr. MCHUGH. I appreciate that.

I would be happy to yield to Mr. Owens.

Mr. OWENS. Mr. Chairman, you have a long list of witnesses, and I think you have thoroughly explored this subject.

I was curious to know why they weren't agreeing with each other, considering they are the two giants in this business. I think, after the conclusion of the dialog between the two of you, you both do agree. You, Mr. Smith, are saying you take off your businessman's hat, and you put on your politician's hat, and you said the reality is that we are going to go forward with the present situation, and we have to learn to live with it. Is that what you are saying?

Mr. SMITH. Yes, sir. Jim is probably better at this than I. I mean, I have gotten my brains kicked in a couple of times up here. [Laughter.]

So I just am more mindful, perhaps, of the reality of trying to get where we need to go without going through this intermediate step. But that would be a fair way to put it, yes.

Mr. OWENS. Memphis is my hometown.

Mr. SMITH. Oh, it is? Great.

Mr. OWENS. So say hello to the folks back home.

Mr. MCHUGH. I thank the gentleman.

Mr. LaTourette.

Mr. LATOURETTE. Thank you, Mr. Chairman.

Both of you gentlemen, when you were testifying, talked a little bit about the international market, and the ability of the Postal Service to compete in the international market. I think, Mr. Smith, you were talking about the fact that it is pretty well documented that they were losing money on some of their international shipments.

Mr. Kelly, when you talked, I wrote down three times you asked the sort of rhetorical question, What is the role of Government? I was wondering if you would care to talk a little bit about the international aspects of the postal market, and I will ask you what you think the role of Government is in the expansion and development of international markets vis-a-vis the U.S. Postal Service and the businesses that you represent?

Mr. KELLY. Thank you.

I believe the Postal Service should continue to focus on the universal delivery of letter mail, and that is what they are there to do, and that is what they should continue to focus on.

I think the whole international arena partially answers the question of why the Private Law Corp. gives to ZAJADA. When you talk about Postal Services expanding into competitive areas, when you talk about Postal Services acquiring private companies, we have a history that is only 2, 3, 4 years old in Europe of where exactly that has happened.

The Deutsche Post, for example, has purchased 6, 8, 10 private delivery companies in Europe. DHL, that the United States Postal Service formed the alliance with this week, is owned, in part, by the Deutsche Post.

Another 25 percent of DHL is owned by Lufthansa. So, in effect, the relationship between the United States Postal Service and DHL, the only one who is going to benefit from that is the German Government. The American taxpayers are going to be disadvantaged by the subsidy of providing first class revenue to support that service in one case, and in the second case, there is no U.S. company that is going to derive any revenue or that is going to pay any taxes on that because it is going to wind up in Germany.

There are some very complex and difficult issues that exist in Europe regarding postal services, and many of them are unfair. The situation is quite different because of the numbers of countries, of course, that exist in Europe. So they are competing with each other. In the United States, there is only one. If they give them the same kind of rights that the Deutsche Post is looking for, it would be devastating to private competitors in this country.

There are virtually no private companies left in Europe.

Mr. LATOURETTE. One of the comments that I think has come from UPS, in particular, that I have seen, has been criticism of the Postal Service's global package link.

When we talk about issues of competitiveness, and I think that Chairman McHugh's excellent work on H.R. 22 is designed to get at competitiveness, but make it truly a level playing field and not a tilted scale, when we talk to the Postal Service about the global package link, they say that it is based upon economies of scale.

So what you are doing when you complain about the fact that they are able to use their subsidization or monopolization to compete unfairly in the international market, well, they are just sending a lot of stuff and so they can do it cheaper. Do you have any thoughts or comments about that?

Mr. KELLY. Yes. I mean, they price that service, as I have mentioned a number of times, for a package to go from San Francisco to London is less expensive than it is to go from San Francisco to Los Angeles. The pricing makes no sense.

The scale that they are talking about has to do with 10,000 packages, but it is not any "X" amount of packages per day. That is over the cost of the year. You can't gain the economies of scale that the Postal Service talks about gaining by spreading out those packages over the course of an entire year.

Mr. LATOURETTE. I was interested in your discussion with the chairman about the Private Law Corp., in particular. Have you

reached a conclusion that there is no firewall big enough or wide enough to fix this problem?

Mr. KELLY. I am reluctant to say that. But if you look at the topic you have just discussed and you think of what they do with the global package link, and you think of what they do with subsidies today, to allow them to compete in additional areas, to allow them to buy private companies, it scares me to death of what they will do going forward. So, yes.

Mr. LATOURETTE. Thank you very much.

Thank you, Mr. Chairman.

Mr. MCHUGH. I thank the gentleman. I want to probe that a little bit further because it is an important point.

My understanding, and I believe it is reflected in Mr. Smith's testimony as well, is the Deutsche Post is actually selling their publicly held postal assets to directly utilize those funds for the purchase of the companies you are concerned about, and I am 99.9 percent certain that is true.

H.R. 22 would totally prohibit that. It could not happen. The DHL-Postal Service joint venture shows that they can do these things today. As you know, they can actually go out and buy—the USPS could buy a company tomorrow, if one person, the Secretary of Transportation, signs off—Treasury, excuse me.

So that, in large measure, we are responding, trying to, to the very concerns you voice because the world that you fear of tomorrow is, I would suggest, far scarier from your perspective without H.R. 22 than it is with it. And I think, again, for a selfish reason, why I urge people to read Mr. Smith's testimony is because those issues are addressed.

I do not, in any way, Mr. Kelly, belittle or wish to treat in a less than serious way the things you have stated. They are real, and I think fairness and the American system of capitalism, in theory, dictates that we look at it. That was part of the motivation and it is truly one of the things that I think is most directly addressed and the concerns that we have. So I just want to put that on the record. I am pleased that Mr. Davis is back, and I would be happy to yield to him.

Mr. DAVIS. Thank you very much, Mr. Chairman.

Gentlemen, let me apologize for having missed your verbal testimony.

The Postal Service has presented a series of amendments. They encompass a number of things, including ratesetting process, pricing flexibility, the Private Law Corp. and others. Could you comment on these amendments, and then I would like to know if you think it would be possible that you would support the bill if those amendments were adopted.

Mr. KELLY. Are you talking about the 32 amendments from the Postal Service?

Mr. DAVIS. Yes, sir.

Mr. KELLY. No. We certainly believe that they are subsidized now. We believe that all of the amendments will give them additional ability to compete unfairly with the private sector, and we absolutely and unequivocally would oppose the bill with the incorporation of the 32 amendments.

Mr. DAVIS. I then ask you if you could comment on how your proposals would effect postal employees or if you think that your proposals could adversely effect postal employees.

Mr. KELLY. We have no intention of adversely affecting any employee group. And we think by focusing on First Class Mail delivery, the Postal Service, through its monopoly, provides an enormous amount of security for its folks that no private company, and, in fact, no other Government group, can provide. But we support that, and we are not looking for anyone to lose their job as a result of anything we are saying here. Our concern, of course, is to, in addition to that, to protect the employees of UPS and Fed Ex and not have them lose their jobs as a result of unfair competition with the Postal Service.

But the Postal Service First Class Mail is continuing to increase, and all of the fears about all of the First Class Mail going away and no one having a job, if the compounded average growth of First Class Mail is 2 or 3 percent over the last 5 years, I don't think that fear has any foundation.

Mr. DAVIS. Do you believe that the current or proposed new bill is better than what currently exists in the arena of competitiveness or promoting a more competitive atmosphere or environment?

Mr. SMITH. I think the short answer to that would be that Jim does not agree with that and we do. We would think it would be better with the bill than without.

Let me also say that we would oppose the Postal Service's amendments for exactly the same reason that he did and, secondarily, that it is my belief that the postal workers of the United States would have more job security, better future outlook, if the Postal Service concentrated on the movement of letters and small items because, regardless of the firewalls and what have you, there will be management diversion and inattention and the cost of letter and small items traffic will be greater with that diversification than without.

The best way to preserve postal jobs is to have the most efficient and lowest cost letter and small package shipment service in the country.

Mr. DAVIS. Recognizing the fact that sometimes it is virtually impossible to arrive at agreement, although we try, I mean, we are always looking for, I think, the common ground or the middle road or the place where there can be co-existence, how far apart do you think you and the Postal Service are in terms of a common ground that might be reached?

Mr. KELLY. When you talk about a common ground, let me again reiterate that we recognize and appreciate the amount of hard work and the amount of change that has gone into this bill, and it is a complex, difficult issue.

There are a few things that concern us, and there are a few things that concern us a great deal, and at this point in time we are not able to support. But if you are talking about a compromise solution that is an interim solution, and when does the rest of it get fixed, and how does the rest of it get fixed, if you want to provide the Postal Service with the ability to compete more, the monopoly has to come away first, I believe.

I don't believe you can provide them with additional competitive authority and allow them to keep the current monopoly that they have. Postal issues really haven't been addressed in a meaningful fashion in 30 years. So if we develop an interim solution, it is going to be a long time down the road before it is fixed again, I would feel.

Mr. DAVIS. So you are saying that there would need to be additional competitive regulation put on the Postal Service to put it more in line with what happens in other parts of the industry.

Mr. SMITH. From FDX's standpoint, we support H.R. 22. So the answer to your question is we have gone as far as we can go with H.R. 22. We would not support the postal amendments.

I think what Jim is saying is, H.R. 22 doesn't go far enough in the direction of the appropriate levels of control.

Mr. KELLY. That is correct.

Mr. SMITH. I mean, that is the only difference. There may be this much difference.

So we certainly wouldn't go toward the Postal Service's position.

Mr. DAVIS. Thank you very much, gentlemen.

Mr. MCHUGH. I thank the gentleman.

We could do this all day, but we won't because you have been very gracious with your time. I am deeply appreciative, as is the entire subcommittee, for that. Just a wild guess on my part, but I bet we will talk again. We are looking forward to that.

Once again, I do appreciate your participation and your efforts to assist the subcommittee in what has been a very interesting journey.

So thank you, gentlemen.

Mr. KELLY. Thank you very much.

Mr. SMITH. Thank you very much, Mr. Chairman.

[Additional questions for Mr. Frederick W. Smith follow:]

**Answers of Frederick W. Smith to
Questions from the House Postal Service Subcommittee
on H.R. 22**

1. The Postal Service has presented a series of amendments to H.R. 22. They encompass changes to the rate setting process, pricing flexibility and the private law corporation, among others. Please comment on their amendments and discuss whether or not you would support the bill if their amendments are, adopted.

FDX has already submitted comments on the first and second set of Postal Service amendments. We will provide comments on the third set of amendments in the next few days.

FDX will support H.R. 22 so long as it retains the careful balance of competing interests now reflected in the bill. As our detailed comments indicate, I do not want to be overly categorical about the Postal Service amendments. Some of the Postal Service amendments would not disturb the balance struck in H.R. 22. Other amendments would disturb that balance if they were adopted as drafted by the Postal Service, but it appears possible to accommodate concerns expressed by the Postal Service with more limited amendments that may not upset the balance of H.R. 22. In regard to still other amendments proposed by the Postal Service, it appears that some give and take may be possible; that is, FDX might support a Postal Service amendment if the same principle could be extended to issues of concern to FDX.

In general, FDX will not support any revision of H.R. 22 that fails to maintain the "firewalls" substantially as proposed in H.R. 22, including provisions providing:

- reliance upon objective factual criteria (degree of effective competition), administered by the Postal Regulatory Commission, to define noncompetitive and competitive categories;
- separation of accounts, both operating accounts and capital assets;
- requirement of an allocation of common overhead costs proportional to the distribution of attributable costs (equal cost coverage rule);
- structural separation for Postal Service participation in joint ventures and non-postal markets;
- an end to legal privileges favoring the Postal Service in the provision of competitive products.

2. (James Kelly, UPS) H.R. 22 has a two-handed approach to competitive products. On one hand, it would require that competitive products collectively make the same percentage overhead contribution as noncompetitive products. On the other hand, the bill gives the

postal service the freedom to set its own rates for competitive products subject only to the constraint that they not be below cost and make the required collective overhead contribution. In addition, the postal service would be able to offer discounts to its customers just as private sector firms can do. Do you believe that on balance, H.R. 22 is an improvement over current law with respect to its treatment of competitive products? Please explain.

[Apparently directed to Mr. Kelly only.]

3. What percentage of the parcel transport market do you control? What percentage of the expedited mail market do you control?

By "parcel transport market", I assume you mean the domestic ground parcel market in which FedEx has no market share. RPS, a subsidiary of FDX, however does have a small share of around 10%. By "expedited mail market", I assume that you mean the domestic next day and second day express service for packages and letters. FedEx has around a 40% market share in this market.

4. The Postal Service recently announced that it has entered into a business alliance with DHL Airways in order to upgrade express mail service to Europe. Is there a difference between this partnership and USPS competitors attempting to form similar partnerships with foreign posts? Please explain.

We are not privy to the details of the DHL deal nor to the details of other deals between post offices and private operators. In general, however, it is not uncommon for post offices and private operators to enter into agreements in which one party collects or delivers mail for the other. My concern about DHL deal is not based so much on the concept as on the absence of adequate regulatory controls to ensure that the Postal Service, DHL, and Deutsche Post are operating on a level playing field vis a vis Federal Express. There is no way to ensure that service resulting from the DHL deal will not be, in effect, trading on special legal privileges, supported by revenues earned from non-competitive products, or financed in part by access to state assets. We support H.R. 22 precisely because it will address several of these issues better than current law.

5. At the February 11th hearing on H.R. 22, I stated that there is a big distinction between those entities that compete with the Postal Service and those the Postal Service targets for competition. Are you a competitor or a target? Please explain.

The Postal Service competes vigorously against FDX in a number of areas. In some cases, we believe the Postal Service has crossed the line into unfair forms of competition, for example, by competing on the basis of customs privileges, postal monopoly regulations, and a claimed immunity from the Lanham Act. This claim of immunity from unfair advertising laws was made when we charged the Postal Service with deceptive advertising in their ad campaign aimed specifically at FedEx. However, I have no evidence that the Postal Service has "targeted" FDX in an extraordinary or extra-competitive sense.

6. Also, at the February 11th hearing on H.R. 22, PRC Commissioner Goldway, in written testimony she submitted, made a number of very laudable comments and suggestions relative to postal reform. I would like your reaction to some of her thoughts:

"H.R. 22 should rely more on the advantages of competition than protecting the marketplace from possible Postal Service competition

"I would oppose loosening the definition of postal product in H.R. 22 . . . to allow for product innovation where there is a nexus to postal operations, and where the Postal Service can show that the new product will benefit from Postal Service scale or scope economies.

"We should not curtail the ability of the postal service to be innovative just because of its size. As the Supreme Court has said, 'low prices benefit consumers regardless of how those prices are set, and so long as they are above predatory levels, they do not threaten competition.' Further it has said, 'it is in the interest of competition to permit dominant firms to engage in vigorous competition, including price competition.'"

What is your reaction to Commissioner Goldway's testimony?

The "advantages of competition" depend upon maintaining conditions of fair and undistorted competition. If, for example, the Postal Service depresses the price in a given market by means of rates which are subsidized by means of monopoly revenues or special legal privileges, then the Postal Service effectively discourages investment in that market to long term detriment of consumers. In the cases cited by Commissioner Goldway, the Supreme Court was discussing competition between private companies where each operated according the same basic rules. H.R. 22 is addressing the far different problem of how to create rules for competition between a federal agency and private companies where, for a major share of its business, the federal agency does not operate under the same rules as its competitors.

Within a framework of fair competition, the specific issue that Commissioner Goldway is raising is the legal test distinguishing when should the Postal Service be able to offer a competitive product directly and when the Postal Service should be required to offer a product by means of a Private Law Corporation. The principle suggested by Commissioner Goldway is that the Postal Service should be able to offer a product directly "where the Postal Service can show that the new product will benefit from Postal Service scale or scope economies."

This principle is already reflected in H.R. 22 since the major source of "scale or scope economies" is the Postal Service's universal delivery network. H.R. 22 would allow the Postal Service to provide directly any "postal product," and defines "postal product" to include "any service that provides for the physical delivery of letters, printed matter, or packages weighing up to 70 pounds, including physical acceptance, collection, sorting, or transportation services ancillary thereto." Thus, H.R. 22 already allows the Postal Service to provide products that share

economies of scale or scope with the universal delivery service network. By focusing on the specific area where the Postal Service enjoys major scale and scope economies, rather than leaving that point open for future litigation, H.R. 22 provides better guidance for all parties concerned. It does not seem to me useful to replace a relatively clear rule with a relatively unclear rule when they seem to come down to the same thing.

If, on the other hand, Commissioner Goldway is proposing that the Postal Service should be able to offer directly products unrelated to the universal delivery service network based on a minor level of scale or scope economies, then I would be inclined to favor the additional safeguards implied by the Private Law Corporation. However, I would like some examples of the Postal Service might do under such a test before commenting further.

7. PRC Commissioner Goldway also made the point in her testimony that H.R. 22, "does not subject the operations of the postal service to federal laws and regulations concerning deceptive advertising." She is referencing the recent LIFE TIME FITNESS complaint case where the PRC found that the postal service's use of language in marketing material for advertising mail "defective and inappropriate." Should H.R. 22 be amended to correct this problem? Please explain.

On this point, I agree with Commissioner Goldway for the reasons given in her March 8th letter to Chairman McHugh.

8. Ted Carrico, President of the National Postmasters of the U.S. also testified on February 11th. He expressed a deep concern about the direct appropriation for the PRC which is contained in H.R. 22. He believes, "that a connection between Congress and the PRC is dangerous because of the potential for congressional 'MIS' management of the postal service and will serve as a new avenue for postal competitors to cripple the postal service." Your reaction?

I agree with Mr. Carrico that the Postal Rate Commission should ultimately answer to a body that will advance the best interests of the United States generally rather than one that advances the interests of particular providers of delivery services. Under the Constitution, it is the job of Congress to reconcile competing interests and determine what governmental policy will advance the interests of the United States generally. While it may be possible to improve Congress as the forge for impartial national policy, the decision making process in Congress is more transparent and more broadly representative of the national interest than the decision making process in the Postal Service or any private operator. Hence, I support the approach of H.R. 22.

Mr. MCHUGH. Panel 3, as we switch placards and turn chairs and such, is comprised of Mr. Jerry Cerasale, who is senior vice president of Government Affairs for DMA, Direct Marketing Association; Mr. Neal Denton, who is executive director of the Alliance of Nonprofit Mailers; Mr. Robert "Kam" Kamerschen, who is speaking on behalf of the Saturation Mailers Coalition.

Gentlemen, welcome. Good to see you all. You know the drill. Stand up and raise your right hands.

[Witnesses sworn.]

Mr. MCHUGH. The record will show that all three of the panelists attested to the oath in the affirmative.

Thank you, gentlemen, for being here. As most everyone knows in this room, you all represent sizable numbers of those who, in different ways, perhaps, but in equally important fashion, both work with and depend upon the U.S. Postal Service. We welcome, too, our efforts to work with you on behalf of your organizations. So thank you for that effort.

Without any further ado, keeping with my very well thought-out plan of earlier, I am going to recognize you in the order in which it was printed on the page, which coincides with the way in which I read it.

So let me yield, first, to Jerry Cerasale, who as I mentioned, is senior vice president of Government Affairs of DMA. Jerry, thank you for being here. We are awaiting your testimony and your spoken words. We have entered all three of your gentlemen's written submissions in their entirety. So, if you could summarize for us, we would greatly appreciate it.

STATEMENTS OF JERRY CERASALE, SENIOR VICE PRESIDENT, GOVERNMENT AFFAIRS DIRECT MARKETING ASSOCIATION, INC., ON BEHALF OF THE MAILERS COALITION FOR POSTAL REFORM; NEAL DENTON, EXECUTIVE DIRECTOR, ALLIANCE OF NONPROFIT MAILERS; AND ROBERT "KAM" KAMERSCHEN, ON BEHALF OF THE SATURATION MAILERS COALITION

Mr. CERASALE. Thank you very much, Mr. Chairman, members of the subcommittee.

The Mailers Coalition for Postal Reform is honored to be here today. The members of the Coalition, the Advertising Mail Marketing Association, American Express Corp., the Direct Marketing Association, Magazine Publishers of America, the Mail Order Association of America, and Parcel Shippers Association, represent mailers who use all classes of mail and also are significant users of competitors of the Postal Service as well.

I am Jerry Cerasale, senior vice president, Government Affairs for the DMA, and I have the privilege, I guess, of appearing before you representing the Coalition today.

The Coalition joined together in an effort to effect postal reform. All of us want a financially viable Postal Service in the 21st century and believe that without reform that goal is not obtainable.

Our Nation is in the midst of the greatest peacetime economic growth in its history. However, during this economic boom, First Class Mail, upon which the financial stability of the Postal Service is very dependent, has not grown very much.

H.R. 22 is not a guarantee that the Postal Service will survive in the 21st century, but it does provide the tools to the Postal Service to have a fighting chance. The burden then will be on the Postal Service management and its workers to improve the competitive edge of the Postal Service by improving productivity dramatically and providing products that meet the needs of the marketplace.

The basic structure of H.R. 22, which separates classes of mail into competitive and noncompetitive categories and provides rate flexibility to the Postal Service, through indexing of the noncompetitive classes being one, is sound and has the Coalition's full support.

Let me focus on those provisions of H.R. 22, which the Coalition believes are central to any postal reform, the competitive and noncompetitive products.

Noncompetitive products should be defined as those products over which the Postal Service has a monopoly by law or through market dominance. Mailers who use such classes need the protections afforded by the indexed rate provisions in H.R. 22.

However, we agree with the amendments suggested by the Postal Service that only the Service may initiate a request to the Postal Regulatory Commission to change a product's classification from noncompetitive to competitive. The Postal Service should have some control over its product offerings. However, once a product becomes competitive, it may not be reclassified as noncompetitive.

Allowing the Postal Service to change its mind and remove a product from the open marketplace would be unfair to competitors who shift their business plans in response to the Postal Service's competitive product offerings. Changing product classifications from noncompetitive to competitive must only be a one-way street.

As we look at the product baskets, and I know I am speaking before Mr. Denton, but we will see what he says about the nonprofit area, and I will gladly, in a question, if it comes up, respond to his position on that, we agree with the rate baskets for noncompetitive products in H.R. 22, except that all international mail should be competitive. The Postal Service faces competition today from both foreign posts and private carriers for all international mail. We think that competition is only going to increase, so we think that we put international mail into the competitive category.

In pricing, we agree with H.R. 22 that the Commission should establish baseline rates under the act without provisions for a contingency or prior years' losses.

As we look at the competitive products, we don't agree with the requirement in H.R. 22 that the minimum markup for competitive classes of mail must be equal to the average markup for all postal products. If H.R. 22 were implemented today, it is our understanding that current rates for competitive classes of mail would have to increase by as much as 10 percent. Thus, H.R. 22 implies that the Postal Rate Commission erred in its most recent decision, and we disagree with that.

We believe that the minimum contribution for competitive classes should be established by the Commission for base rates after applying all of the factors of the act. This would maintain the level playing field for postal competitors that the Commission established.

Finally, we believe that after 5 years this minimum contribution requirement should sunset. We think that 5 years provides ample time for the Postal Service and its competitors to adjust to the marketplace, and the Postal Service would have to not do business at a loss and charge a fair-market price.

Looking at the noncompetitive products, we wholeheartedly agree with the index in H.R. 22 used to establish noncompetitive rates. There must be a productivity factor specifically applied to the Consumer Price Index as part of that index. This is needed as an incentive to the Postal Service to hold down costs. We strongly object to the Postal Service's amendment to remove the productivity factor "because the CPI already contains productivity improvements."

The Postal Service should be required to do more than merely match productivity gains in the general economy. To fail to do so will imperil the Postal Service and the mail industry that depends on universal mail delivery.

We also believe, however, that the pricing provisions in H.R. 22 are too rigid. Its application of the rate bands around the index severely reduces the pricing flexibility that we think the Postal Service needs. We have varying opinions about the specific method that best achieves the appropriate level of flexibility, but we believe that the provisions of the bill must be changed to provide some greater flexibility than H.R. 22 currently offers.

We disagree with the Postal Service amendments that would allow the Postal Service to bank for up to 5 years any percentage increase allowed under the index, which was unused in a specific year by the Postal Service. If there is going to be any banking, we think 1 year would be a maximum.

Special financial circumstances. There are three areas where we think that H.R. 22 may require some changes for special circumstances. The first is, if the Postal Service doesn't have enough money to run under the provisions of H.R. 22. We think in that case, the Postal Service should have to come to the Regulatory Commission and set up a brand new base case to establishing rates.

A second area is when something occurs by Congress or executive or judicial branch that results in additional costs unforeseen on the Postal Service. We think, then, the Postal Service should be able to go to the Regulatory Commission and ask for a one-time adjustment in the index to take care of it. Don't let that adjustment stay in effect for 3, 4, 5 years because that will be overpaying the Postal Service for that adjustment.

The third area when there could be some circumstances to go beyond the index, would be when a specific rate is too low, the Postal Service is not covering its costs in a class of mail. We think the Postal Service should have to go to the Regulatory Commission and adjust, one time, the index, make an adjustment in the index, to increase the rates for that class on a one-time basis and then go on, under the current provisions, with the index previously set by the Regulatory Commission for the remainder of the 5 years.

Market tests. It is important that the Postal Service have the ability to test new products, and I want to use the example with DHL as an example of potentially a market test. We agree that the Postal Service should have the ability to try and test products and

products that may turn out to be a bust, products that may turn out to not cover their costs, but have the ability to test them. Otherwise the Postal Service is going to be hampered in its ability to meet market needs.

We do support very much the provisions of H.R. 22 in this area, but do agree with the Postal Service on one amendment; increase the test side to \$100 million.

Negotiated Service Agreements. We wholeheartedly endorse NSA's. We, however, agree with the Postal Service that these agreements should be implemented immediately after the Postal Service provides public notice of the agreement and all its terms. We would then set up complaint procedures. After the notice, any party that believes it can meet the terms of the agreement would be eligible for the NSA, and if that party is denied a similar agreement, they may complain to the Regulatory Commission.

In the same light, any party that feels that the noticed agreement violates the provisions of H.R. 22, such as there is no way they could be covering costs, for example, they should be able to complain to the Postal Regulatory Commission. We then think that the Commission should have 90 days to render a decision, a final decision, which would be subject to judicial review.

Complaint procedures. Similar to what we say for NSAs, we agree that users of the mail and competitors of the Postal Service must have an avenue of redress for any grievances concerning alleged abuse by the Postal Service of its regulatory discretion. Again, the Commission should have 90 days to issue a decision in the complaint and such decision should be final subject to judicial review.

We really appreciate this opportunity to be here today, and I am ready to stand for any questions.

[The prepared statement of Mr. Cerasale follows:]

TESTIMONY OF JERRY CERASALE
ON BEHALF OF
THE MAILERS COALITION FOR POSTAL REFORM
BEFORE THE SUBCOMMITTEE ON THE POSTAL SERVICE
COMMITTEE ON GOVERNMENT REFORM
U. S. HOUSE OF REPRESENTATIVES

March 4, 1999

Chairman McHugh and members of the Subcommittee, the Mailers Coalition for Postal Reform is honored to testify before you today. The Coalition was formed specifically to present a uniform voice for business mailers on the complicated question of postal reform. The members of the Coalition, Advertising Mail Marketing Association, American Express, The Direct Marketing Association, Magazine Publishers of America, Mail Order Association of America, and Parcel Shippers Association, represent mailers who use all classes of mail and are significant users of the competitors of the Postal Service as well. I am Jerry Cerasale, Senior Vice President, Government Affairs, for the Direct Marketing Association, and I have the privilege of representing the Coalition at this hearing.

We joined together in an effort to effect postal reform. All of us want a financially viable Postal Service in the 21st Century and believe that without reform that goal is unattainable. This subcommittee has been on a four-year journey to reform the Postal Service. That journey began with your belief that the electronic information age would severely reduce mail volume and, thus, financially burden the Postal Service. The Service should be allowed more freedom to adjust its prices and services to meet the challenges of competition.

We can see today that your belief was justified. Our nation is in the midst of the greatest peacetime economic growth in its history. However, during this economic boom First-Class Mail, upon which the financial stability of the Postal Service is dependent, has not grown.

H.R. 22 is not a guarantee that the Postal Service will survive well into the 21st Century, but it provides the tools the Service needs to have a fighting chance. The burden then will be upon postal management and labor to improve the competitive edge of the Service by increasing productivity and providing products that meet the needs of the marketplace.

The basic structure of H.R. 22, which separates classes of mail into competitive and non-competitive categories and provides rate flexibility to the Postal Service (through indexing for the non-competitive classes), is sound and has the Coalition's full support.

In this testimony I will focus on those provisions of H.R. 22 that cover establishing postal rates, classes and services, which the Coalition believes are central to any postal reform.

COMPETITIVE AND NON-COMPETITIVE PRODUCTS

Non-competitive products should be defined as those products over which the Postal Service has a monopoly by law or through market dominance. The Service should not have the *carte blanche* discretion to set rates that H.R. 22 affords competitive classes if, in fact, the Postal Service has a monopoly over that class. Mailers who use such classes need the protections afforded by the indexed rate provisions in H.R. 22.

We do agree, however, with the amendment suggested by the Postal Service that only the Service may initiate a request to the Postal Regulatory Commission to change a product's classification from non-competitive to competitive. The Postal Service should have control over its product offerings. However, once a product becomes competitive, it may not be reclassified as non-competitive. Allowing the Postal Service to change its mind and remove a product from the open market place would be unfair to competitors who shift their business plans in response to the Postal Service's competitive product offerings. Changing product classifications from non-competitive to competitive must be a one-way street.

PRODUCT BASKETS

We agree with the rate baskets for non-competitive products in H.R. 22 except that all international mail should be competitive. Thus, Basket One of H.R. 22 should not contain single piece international mail. The Postal Service faces competition today from both foreign posts and private carriers for all international mail. That competition will only increase.

PRICING

We agree with H.R. 22 that the Commission should establish base line rates under the Act without provisions for contingency and prior years' losses. However, if the Commission has issued a recommended decision in an omnibus rate case within one year of the effective date of postal reform, that decision, as implemented by the Governors, should be the base line rates.

Competitive Products

We do not agree with the requirement in H.R. 22 that the minimum mark-up for competitive classes of mail must equal the average mark-up for all postal products. This provision is too restrictive and is counterproductive to the goal of giving the Postal Service the tools to survive in the 21st Century. If H.R. 22 were implemented today, current rates for the competitive classes of mail would have to increase as much as 10%. Thus, H.R. 22 implies that the Postal Rate Commission erred in its most recent decision. We strongly disagree. The Commission fairly applied the factors in the Postal Reorganization Act and established fair and equitable rates. H.R. 22 should not reverse the Commission.

We believe that the minimum contribution for competitive classes should be established by the Commission for base rates after applying all the factors of the Act. The minimum contribution should be calculated on a revenue-weighted basis for all the contributions of the competitive subclasses. This would maintain the "level playing field" for Postal Service competitors that the Commission established. Finally, we believe that the minimum contribution should sunset after five years. The five-year period provides ample time for both the Postal Service and its competitors to adjust to the new market place. After five years the Postal Service should be on the same footing as its competitors for competitive products—don't do business at a loss, but charge a fair market price.

Non-competitive Products

We whole-heartedly agree with the index in H.R. 22 used for establishing rates for non-competitive products. There must be a productivity factor specifically applied to the CPI. This is needed as an incentive to the Postal Service to hold down costs. Survival in the 21st Century requires that the Postal Service dramatically improve productivity. We strongly object to the Postal Service's amendment to remove the productivity factor because the CPI already contains productivity improvement. The Service should be required to do more than merely match productivity gains in the general economy. To fail to do so will imperil the Postal Service and the mail industry that depends on universal mail delivery. We urge this Subcommittee to require the Postal Service to meet defined productivity improvements in order to adjust rates using the index.

We also believe, however, that the pricing provisions in H.R. 22 are too rigid. Its application of the rate bands around the index severely reduces the pricing flexibility the Postal Service needs. There are varying opinions about the specific method that best achieves the appropriate level of flexibility, but we believe that the provisions of the bill must be changed to provide greater flexibility than H.R. 22 currently offers.

We disagree with the Postal Service amendments to allow the Postal Service to "bank" for up to five years any percentage increase allowed under the index which was unused in a specific year. Such a plan would undermine, if not eliminate, one of our objectives for postal reform—to have smaller, predictable, and manageable annual rate increases. At the most, the Postal Service should be allowed to "bank" any unused percentage for only one year. That would provide a little more flexibility for the Service but would not undermine the manageable annual rate increase goal.

"SPECIAL" FINANCIAL CIRCUMSTANCES

We believe that certain financial circumstances require special treatment in H.R. 22. Whenever the Postal Service faces a *severe* financial exigency and additional revenue is needed, the Postal Service should be permitted to address this need through an exigent rate case filed with the Postal Regulatory Commission. We understand that such a case would be a major admission by postal management that they had failed to control costs—an incentive to control costs.

There may also be circumstances where legislative, executive, or judicial action, which is beyond the control of the Postal Service, results in unforeseen cost increases. In such circumstances where the cost increase exceeds the increases allowed under the index, the Postal Service should have the authority to petition the PRC for a waiver of the index. The PRC could waive the index and permit a one-time adjustment that would be passed uniformly to all mail users.

There may also be circumstances where the rates assigned to a particular subclass may fail to recover that subclass' costs. In such a case for non-competitive subclasses, the Postal Service should have the authority to petition the PRC for a waiver of the index for that subclass on a one-time, one-year adjustment basis. Whenever a competitive subclass fails to cover costs, the Postal Service immediately must raise rates for that subclass to cover costs.

MARKET TESTS

It is important that the Postal Service have the ability to test new products. More importantly, it must be allowed to test products that ultimately fail due to lack of demand or inability to cover costs. Without that freedom, the Postal Service will be tied to existing products and have very limited ability to adjust to the information age. We support the provisions in H.R. 22 with one amendment. We would increase the allowed size of the test to \$100 million as proposed by the Postal Service.

NEGOTIATED SERVICE AGREEMENTS

In short, we applaud you for the negotiated service agreement provisions in H.R. 22. We do, however, agree with the Postal Service that these agreements should be implemented immediately after the Postal Service provides public notice of the agreement and all its terms. After the notice, any party that believes it can meet the terms of the agreement would also be eligible for that NSA. If that party is denied a similar agreement, it may complain to the Postal Regulatory Commission. In the same light, any party that believes that the noticed agreement violates the provisions of H.R. 22 may complain to the Postal Regulatory Commission. The Commission will have 90 days to render a decision which will be final subject to judicial review.

COMPLAINT PROCEDURES

Users of the mail and competitors of the Postal Service must have an avenue for redress of any grievances concerning alleged abuse by the Postal Service of its regulatory discretion. Complaints should include allegations concerning: (1) failure to render services in accordance with service performance standards established by the Board of Directors of the Postal Service; (2) violation of pricing discretion within the bounds of the index; (3) predatory pricing; (4) unreasonable discrimination relating to a negotiated service agreement. The Postal Regulatory Commission shall have 90 days to issue a decision in a complaint. Any such decision is final, subject to judicial review.

We appreciate this opportunity to present our views to the Subcommittee. We look forward to working with you to enact this long-needed reform.

Mr. MCHUGH. Thank you very much, Jerry. We appreciate that.

Next on the list is Neal Denton, the executive director of the Alliance of Nonprofit Mailers. Neal, good to see you. Thank you for being here, and we look forward to your comments.

Mr. DENTON. Thank you, Mr. Chairman, Mr. Davis and to the good staff sitting next to you and behind you. We appreciate this entire process that we have been through over the last several years.

In preparing for today, I enjoyed reading some of the testimony that we have delivered and my colleagues here have delivered over the many years, as we have all gotten to know a little bit more about how the Postal Service runs and what types of possibilities are out there for meaningful reform.

As you know, and we have been very clear with this every time we have talked with you, we have had very grave reservations over the many years about certain concepts in postal reform that would give the Postal Service greater freedom and flexibility to set postal rates. We believe that the most recent increases of January 10 offer some glaring examples of the types of abuse we have feared in an unfettered rate-setting environment.

I appreciate your comments in the beginning of the hearings today about nonprofit mailers having concerns here. Chairman Burton, in the last hearing, was right on the mark when, in recognizing the Postal Service surpluses over the last 4 years, questioned the Postmaster General as to whether we should have had any rate increases at all on January 10.

As each of you know, the Alliance of Nonprofit Mailers is currently in litigation before the court of appeals over this case because we do believe that the increases of January 10 were unfair, that the increases of January 10 were unnecessary, and that they were unlawful.

Unfair because, while the price of a first class stamp may have only gone up 1 cent, the price for a nonprofit basic standard A mail piece went up 3 cents.

Unfair because, as each of you know, the rate increases imposed on nonprofit periodical publications in some instances cause a nonprofit educational magazine with no advertising to pay a higher postal rate than an identical commercial periodical publication thick with advertising. That is a rate anomaly that represents unfair rates that nonprofits are experiencing since January 10.

We believe they were unlawful. Because, as Mr. Burton pointed out, the Postal Service didn't lose \$1.1 billion in fiscal year 1998, as they forecasted. The Postal Service made \$550 million. They enjoyed a \$550 million surplus, and because of that we believe that the case was unlawful. The Postal Service is supposed to, by law, break even. They are not supposed to be enjoying these kind of surpluses. We can't turn a monopoly governmental authority loose to be making profits on the back of captive monopoly mailers.

Now, all of this said, and it is important that I say it again because we have said it every time here, we do come to the table understanding the potential problems that face the national mail delivery network and recognizing that there must be some realities of political reform that all of us can talk about here that can help

to move our national mail delivery network into the coming century.

We have looked at H.R. 22, and we have worked with you and your staff, and there are some provisions in H.R. 22 that we find very admirable and that we support; the caps and 2-percent bands provisions that protect all mailers from being singled out for especially damaging rate increases—the kind of rate increases nonprofits have faced as a result of the January 10 hikes.

The bill also protects any mailers from the over-the-cap increases that could happen in consecutive periods; that is, the Postal Service can't pile on 2 percent above CPI increases in consecutive years. Nonprofit mailers were terribly concerned about that.

There are three provisions that are specific to nonprofits that we have been very supportive of—one that would change the language mandating the overhead assignment for nonprofit mailers. It is very technical, but currently the law says that nonprofit overhead shall be 50 percent of the closely corresponding commercial overhead, and the bill would actually say no greater than 50 percent, which would allow some flexibility underneath that. That would be very welcome by nonprofit mailers.

It also provides an important safeguard to prevent the Postal Service from attributing more cost to nonprofit mail than to an identical size, shape, weight commercial mail piece. That is very important. We are far away from that right now. But the way that the rate structure has been moving over the last several years, I like the idea of having that ceiling put in there firmly, so that the Postal Service can't creep above that in a coming rate case.

The bill also authorizes nonprofit requester publications, an amendment that is something that we have thanked you for before and looked forward to seeing in the final bill.

We also reviewed the Postal Service's proposed amendments. We spent quite some time looking at those. I think, after reviewing all of them, we probably have criticism with just about every one of them, except perhaps one. The Postal Service amendment that suggests that the "x" factor for productivity is superfluous and that the CPI already accounts for productivity, I believe is nonsensical. I agree with my colleague, Mr. Cerasale, over here. We ask you to continue to rely upon the H.R. 22 provisions that would allow the Postal Regulatory Commission to set a productivity offset to the index.

Frankly, in my mind, it is highly disturbing that any senior postal official would stand before you or before a large group of their customers and be so flippant as to suggest that potential productivity gains in future operations would be so insignificant as to not even include it in any legislative formula for setting rates. That is very disturbing, and perhaps we must overcome that type of thinking before any of these provisions in here are going to be successful.

The mailers that have supported H.R. 22 aren't here because we like the idea of getting increased rates every year. We are here because we like the idea of the Postal Service, given productivity gains, being able to hold the cost of postage down.

If the Postal Service is going to spend their time and energy promoting a legislative proposal that doesn't measure these productivity gains, I find that again very, very disturbing.

We appreciate that many in the mailing community, and most especially, I am sure the colleagues joining me at this table today, are attracted by negotiated service agreements. As you know, over the years we have had an awful lot of concerns with the concept of NSA's, but we believe that the concerns that we have voiced to you over these years have been addressed very adequately in H.R. 22. For instance, the recovery of attributable cost and a fair portion of institutional costs, having the whole thing done in the open air before the Commission so that other organizations have an equal opportunity to participate in these programs, so that they will have an opportunity to also apply for these same types of NSA's in these open proceedings. We find that very agreeable, and we would support those safeguards and protective criteria and would reject the Postal Service's amendments to that.

As I mentioned, though, one of the Postal Service's proposals does merit some consideration. Mr. Cerasale brushed upon it briefly, and that is, we are fascinated with the idea of creating a separate basket for preferred rate mailers. We have always been concerned that by averaging a basket of similar commercial and nonprofit mail, preferred rate mailers might fare poorly. The notion that all preferred rate mail be averaged separately is very interesting. However, the Postal Service's proposal would lump nonprofit standard A and nonprofit periodicals in the same basket. That would be apples and oranges in the same basket, and there is no other basket that is included in H.R. 22 that would contain two distinctly different types of mail than the one the Postal Service would propose here.

I think we would take the metaphor a little bit further, and I would get poked in the ribs by my colleagues who would. We have a basket at home. My wife and I have a picnic basket at home that has a divider down the middle, and I believe that if somehow we could create a nonprofit basket that would allow one-half of the basket to average out for those standard A products and one-half of the basket to average out to the CPI minus X for the periodical publications, and then the whole basket average out to meet that index, that would be very agreeable and might be an improvement upon what it is that we see with H.R. 22.

I have discussed it with my colleagues that also represent nonprofit mailers, and I think that is something we might be able to work on if we talk a little more about it.

The subcommittee also recently heard the testimony of the Postal Rate Commission and Chairman Gleiman. Included in our full remarks that you have incorporated into the record are some comments we have about their proposals, and I think they are very favorable.

While I have your attention, I want to bring up one other subject, that you and I have talked about that in the past. It is a serious problem. We have recently witnessed some very unseemly bullying and harassing of nonprofit mailers over questionable revenue deficiencies, all under the name of the Postal Service's Revenue Protection Program.

Postal inspectors and others should be commended for identifying fraud and illegal activity that robs resources from the Postal Service. Inspectors and others should also have the sense to know the difference between a criminal who is attempting to defraud the Postal Service and a nonprofit librarian who is advertising educational trips.

As you know, eligibility restrictions outline what a nonprofit mailer can and what a nonprofit mailer cannot advertise in a preferred-rate mail piece. Many of the rules are shaded in gray generalities, the policies are often unclear not only to the mailers, but to postal officials, and the rules are very often applied differently across the country by different postal officials.

I am very sorry to report that some of the Postal Service agents have aggressively attempted to bankrupt community-based nonprofit organizations or drive eligible mailings out of the nonprofit mail stream with very questionable Postal Service interpretations of the eligibility restrictions. This disturbs us greatly.

We would like to discuss this further with each of you because we believe that perhaps the blueprint used in the series of hearings last year on the heavy-handed approaches of the Internal Revenue Service might well be in order as we evaluate some of the methods used by the Postal Service in squeezing revenue from some nonprofit postal customers.

We thank you for your fair and insightful approach to protecting the viability of our Postal Service, and I join with Mr. Cerasale in looking forward to your questions.

[The prepared statement of Mr. Denton follows:]



March 4, 1999

**TESTIMONY BEFORE
HOUSE GOVERNMENT REFORM COMMITTEE
SUBCOMMITTEE ON THE POSTAL SERVICE**

**Neal Denton, Executive Director
Alliance of Nonprofit Mailers
Washington, DC**

President
Mark Silbergold
Consumers Union of U.S., Inc.
Vice President
Alan Kline
American Management Association
Secretary
Fred Lucien
American Association
of Retired Persons
Treasurer
Joseph Segga
American Lung Association
Executive Director
Neal Denton

Mr. Chairman, thank you for the opportunity to continue our open dialogue with you and the Subcommittee. Over the last four years, we have appreciated the occasions to present formal testimony to you. More importantly, we have respected the process that you, your colleagues and the outstanding Subcommittee staff have created to find fair answers to the complex questions before us.

The Alliance of Nonprofit Mailers represents over 200 nonprofit organizations, as well as their affiliates, chapters and vendors. As you know, our membership stretches throughout all segments of the nonprofit community — incorporating religious, charitable, educational, scientific and philanthropic groups alike.

In preparing to speak with you today, I enjoyed reviewing our testimony and communications from the early days when we were *all* learning more about the challenges before the Postal Service and the possibilities for meaningful reform. We appreciate that many of our concerns have been addressed in provisions now included in HR 22.

Over the years, we have had very grave reservations about certain concepts in postal reform that would give the Postal Service greater freedom and flexibility in setting postal rates. The most recent increases of January 10 offer glaring examples of the types of abuse that we fear in an unfettered ratesetting environment.

Full Committee Chairman Burton was right on the mark during the last hearing of this Subcommittee. Recognizing the record surpluses enjoyed by the Postal Service over the last five years, he questioned the necessity of the recent rate hikes.

Contrary to the comments of the Postmaster General, the January 10 increases *were* unfair, unnecessary and unlawful.

Unfair to nonprofit mailers because while the price of a First Class stamp rose by 1 cent, the price of basic nonprofit Standard A mail rose 3 cents. Moreover, the new rate structure is so bizarre that a nonprofit educational publication with no advertising can pay *higher* postal rates than a commercial publication, thick with advertising, of identical size, shape and weight.

Unnecessary because the Postal Service did not lose \$1.1 billion in test year 1998 as they forecasted — but instead enjoyed a \$550 million surplus in FY 1998.

Unlawful because by law, the USPS is supposed to break even. The US Court of Appeals will soon rule on our contention that the excessive rate increases violated the statute. When the Governors approved the January 10 increases, they knew that the existing rates sufficed to allow for a surplus, but they implemented the increases anyway. We can't turn a monopoly government authority loose to be raking in profits on the backs of captive American consumers.

And therein remains our most serious concern with reforms that offer the USPS more freedom to set prices without rigorous oversight before the Rate Commission in an open proceeding.

We recognize that our judgment has been shaped (and reinforced) by our recent history of unfair treatment by the Postal Service. We just don't trust the management and leadership of the Postal Service to always do the right or fair thing for postal consumers or, particularly, our constituents.

That said (and we've said it every time we've testified before this panel), we also understand the potential problems that face the national mail delivery network in the coming years. Many fear the diversion of mail to electronic competition. We've heard USPS management trumpet the arrival of foreign interests who scheme to invade US markets and overtake the Postal Service. And, although we may be more skeptical than others, we bow to our learned colleagues in the postal community who fervently believe that reforms are necessary.

So, despite continuing to have grave reservations, we have given open-minded consideration to the types of reform that may be required to bring our Postal Service into the next century, while continuing to seek protections from the unfair treatment foisted on some consumers, particularly nonprofit mailers, in recent rate case proceedings.

As I mentioned earlier, HR 22 now contains a number of provisions that respond directly to our concerns.

- The bill creates a fair system of a rate increase “cap” and 2% “bands” that would protect nonprofits (and other mailers) from being “singled-out” by the USPS for especially damaging rate increases (as in Docket R97-1).
- The bill would protect mailers from “above the cap” increases in consecutive periods. That is, the USPS could not “pile on” a series of CPI+2% increases year after year.
- In response to our concerns, the bill would also change the language mandating that nonprofit overhead (*i.e.*, institutional) costs remain at 50% to read “no greater than 50%.” Both the USPS and the PRC have told us that this provision likely would have mitigated the R97-1 increases on nonprofit mailers. [Section 202(i)]
- The bill also offers an important safeguard to prevent the USPS from attributing more costs to nonprofit mail than to commercial rate mail with identical characteristics. Although the costs attributed to nonprofit mail are still well below this threshold, the Postal Service has reported unexplained and disproportionately high cost increases for the nonprofit subclass. The language in the bill is another safeguard to prevent tampering with preferred rates in the future. [Section 201, 3722]
- The revision also contains language crafted by the Alliance to ensure the authorization of nonprofit Periodicals (second-class) “requester” publication status. Presently, nonprofit publications must only mail to a list of subscribers, whereas regular periodical publications can mail to unpaid “requesters.” Such a correction would allow for greater dissemination of educational material and for greater contributions to USPS institutional costs. [Section 215]
- The bill also retains authorization for annual appropriations to the USPS for preferred rate mail, free mail for the blind, and voter registration mail. Earlier drafts would have ended those appropriations and called upon the USPS to assume full responsibility for congressionally mandated social obligations.

This Subcommittee will soon move forward with a final version of HR 22 that will become a topic of debate in the full committee and eventually, the full House of Representatives. As you prepare your final modifications, we offer these points for your consideration and review.

USPS Proposed Amendments

Frankly, we were surprised by the thrust of the recently-proposed USPS amendments, many of which would dismantle the best parts of HR 22.

- The confusing notion of “banking” rate increases to be applied later, at the discretion of USPS management, cuts directly to the predictability and moderation of rate increases, and should be rejected.
- The USPS amendments also suggest that the “x-factor” for productivity is superfluous and that the CPI already accounts for productivity. This is nonsensical. We ask that you continue to rely upon the HR 22 provisions that allow the PRC to set a productivity offset to the index.

Frankly, it’s highly disturbing that *any* senior postal official would be so flippant as to suggest that potential productivity gains in future operations would be so insignificant. Perhaps we must overcome that type of thinking before any legislative reforms can be implemented.

I’m also concerned about the Postal Service’s lack of candor with regard to this point. Improving productivity was the main rationale offered by the USPS in the recent rate case for its \$1.6 billion-a-year rate increase. And the Postal Service’s recent Annual Report for 1998 boasts of strategic plans *“to improve Total Factor Productivity over time at a rate that at least equals or exceeds any improvement in the private sector MFP”* (Multifactor Productivity).

- The USPS also proposed that the baseline rate case envisioned in HR 22 be rejected and that rates in effect eight months after the passage of HR 22 become the baseline. While we’d love to avoid another rate case, the existing rates should not serve as the baseline rates for the statutory escalation formula. As we have outlined, the R97-1 rate structure is unlawful and unfair and the costing figures are inherently flawed. The revenue requirement was also poorly conceived. It includes a recovery of prior year’s losses, which will not continue indefinitely. The full cost-saving effects of automation and worksharing were not accounted for, and the increase included a number of extraordinary one-time management initiatives, such as addressing the Y2K problem. In our view, the resulting rates generate more than \$1.6 billion a year in illegal monopoly profits, and the entire set of rate changes was illegal.
- We appreciate that many in the mailing community find the prospect of negotiated service agreements (NSAs) to be a very attractive tool for adding value for customers and the USPS. Many of our concerns with offering contract rates are addressed very adequately in HR 22 (e.g., recovery of attributable costs and a fair portion of institutional costs; equal opportunity for mailer participation; and open proceedings before the PRC to evaluate the agreement). We support those safeguards and protective criteria and would reject the secret deal making that would likely follow from the USPS amendments.

- We are troubled by USPS proposals on the pricing of competitive products. The USPS amendments eventually would allow the markup of overhead contributions from competitive products to lapse and also would tinker with the attributable costs assigned competitive products. These proposals should be rejected.
- And finally, we have strong reservations with respect to the Private Law Corporation. Although the pursuit of competitive products, which may or may not be postal related, may be attractive to some, we are concerned that it will cause officials at Postal Headquarters to “take their eye off the ball.” And we’re not at all sure that the generation of profits by the Private Law Corporation will translate into savings and benefits for captive consumers of the monopoly. After reviewing the USPS proposed amendments, we’re certain others in the postal community will have more to say about the slope of that playing field.

One USPS amendment does merit consideration. We are fascinated with the idea of creating a separate “basket” for preferred rate products. We have always been concerned that by averaging a basket of similar commercial and nonprofit mail, preferred rate mailers would fare poorly. The notion that all preferred rate mail be averaged separately is interesting.

However, the USPS proposes to lump nonprofit Standard A and nonprofit Periodicals mail in the same basket. We warn that this could lead to serious, unanticipated problems. Unlike other baskets, the preferred rate basket would contain dramatically different types of mail. The USPS would be costing and pricing apples and oranges from the same basket. The volatility of costs, prices and rates would be unpredictable.

Allow me to stretch the basket metaphor a bit. My wife and I have a picnic basket at home that is divided in the middle. If the entire preferred rate basket of products (Standard A and Periodicals combined) met the average indexed increases, *and* each of the separate categories within the basket (Standard A and Periodicals individually) met the indexed increases, then we believe this would be a most acceptable improvement upon HR 22.

PRC Proposed Amendments

The Subcommittee recently heard the testimony of the Postal Rate Commission Chairman Gleiman, who offered a very interesting perspective and stern warnings about USPS proposals for the private law corporation. As we continue to digest his testimony, we wish to underscore some of his suggested enhancements of HR 22 that we find to be both reasonable and favorable.

- Specific language requiring worksharing discounts to reflect full cost savings would be an enhancement of the bill — especially as it pertains to negotiated service agreements.
- Likewise, a clear definition of the term “product,” specifying that each rate cell is a product, might prevent confusion in the future.

- We most affirmatively support allowing the PRC authority to set annual adjustment factors to reflect evidence of increased productivity gains. The only way to put a true cap on postal rates is through increased productivity. I don't think mailers are here because we look forward to annual postal rate increases. The promise of enhanced productivity driven by management incentives is the real payoff for postal consumers in HR 22.

We also would like to repeat a proposal that we suggested in 1996. There seems to be quite a bit of discussion over the quality and qualifications of the USPS Board of Governors. After evaluating recent decisions by the Board, we continue to wonder why individual Governors have no personal staff. The USPS is a \$60 billion business. Although the addition of the Office of the Inspector General is a valuable tool, we also believe that an independent staff member for each Governor would improve the quality of decision-making by part-time Board members. Such a change would also be consistent with the trend in recent years toward more activist oversight by corporate boards of directors in the private sector.

And finally, while I have your attention, we'd like to comment on one other serious problem facing postal consumers and, most particularly, nonprofit mailers. We believe that some divisions of the Postal Service have gone entirely overboard in "revenue protection" efforts.

Although Postal Inspectors and others should be commended for identifying fraud and other illegal activity that robs resources from the Postal Service, we have witnessed unseemly bullying and harassing of nonprofit mailers over questionable revenue deficiencies. As you know, eligibility restrictions outline what a nonprofit mailer can or can't advertise in a preferred rate mailpiece. Many of the rules are shaded in gray generalities; the policies are often unclear to the mailer and incorrectly applied by the postal official. Some USPS agents have aggressively attempted to bankrupt community-based nonprofit organizations, or drive eligible mailings out of the nonprofit mailstream, with questionable USPS interpretations of the eligibility restrictions.

We'd like to discuss this further with you, the whole Subcommittee and staff. The same blueprint used in the series of hearings on the heavy-handed approaches of the Internal Revenue Service might be in order as we evaluate the methods used by the USPS in squeezing revenue from some postal consumers, especially nonprofit mailers.

We thank you and your colleagues for your fair, careful and insightful approach to protecting the viability of our postal service into the next century.

Mr. MCHUGH. Thank you very much, Neal. As we discussed, we look forward to working with you on those other kinds of issues, as we have in the past. I have written the chairman of the Board of Governors with respect to that anomaly on R97-1, and certainly the other concerns that you have are legitimate. We want to try to be able to be of assistance in probing those to an equitable solution in addition.

Last, on this panel, is, as I said earlier, Kam Kamerschen, who is appearing on behalf of the Saturation Mailers Coalition. Kam, thank you as well for being here, and we look forward to your comments, sir.

Mr. KAMERSCHEN. Mr. Chairman, and members of the committee, staff, I am Robert "Kam" Kamerschen, chairman of the board of ADVO, Inc. ADVO, as you know, distributes targeted saturation advertising mail to 60 million households every week. We represent 23,000 clients of all sizes and shapes, and make no mistake about it, our destiny is closely tied to the success of the Postal Service.

In many ways, I could dramatize that, but make it this way. The term "partner" is often used sometimes loosely. But I would submit the U.S. Postal Service is, indeed, our partner because 50 cents out of every dollar of revenue that we generate as a public corporation goes to the U.S. Postal Service in the form of postage. I think that sounds like a partnership, to me.

I am here representing today the Saturation Mail Coalition. Inasmuch as that might not be familiar to many of you, let me tell you what it is all about. We represent 40 different companies that are essentially in three or four basic areas: weekly community newspapers, shopper publications, envelope coupon mailers, and other shared mailers like ourselves.

To give you a frame of reference, those members run from relatively large companies, like Harte-Hanks, Money Mailer, people of that vestige, to very small operators who mail 15,000 to 20,000 households, which is essentially the size of a ZIP Code, as you know, and so it is quite a diversity of groups.

The commonalities we have are that we are basically servicing a group of retailers and/or other service operators who depend very much on us in order to deliver their mail in a dependable, affordable fashion. Moreover, there is a bunch of consumers that also share the enthusiasm for that, as evidenced by the fact that every week we deliver important information on products, services, as well as coupons that represent huge savings to the consumer.

Now, just as a frame of reference, since we are going in every household every week with different mailing organizations, what it says is that we are becoming available to all consumers, and that is a very important aspect from our dimension in that we are not discriminating. We are making these savings available to all of the public, and as a frame of reference or contrast, for example, the FSI's, the freestanding inserts, which represent savings to the consumer for coupons, are delivered with the purchase of a Sunday newspaper. So we believe we are delivering a valuable service, indeed.

We really feel, as I indicated, that mail is our preferred form of distribution, even though some of us do use private carrier delivery

as well. We believe that way. It is our preferred option because of the basic credibility and reliability the Postal Service represents, which has made major improvements, as you know, from as recently as 5 years ago, and we certainly feel that way.

I believe the crux of this whole conversation about fairness, competitiveness, level playing field, resides in a very simple fact. The fact is that the Postal Service, by definition, by law, is accountable and responsible for universal service, and here is the quandary: Each year the fundamental cost of the national infrastructure for providing that service is growing. It is growing because there are an additional number of households every year. Just in my tenure with the company, in this industry, which is only 10 years of length, I have seen an enormous increase of several million households every single year being fueled, obviously, by a high divorce rate and other considerations.

So the infrastructure has got to keep growing. And, in turn, the Postal Service has to be able to finance that. The only way that I know of that we can finance that is a combination, I guess, of greater productivity, cost savings, but also growth. Growth is the imperative that we believe exists in helping to fuel that particular proposition.

The subcommittee's goal is obviously modernizing and reforming the Postal Service, and we certainly applaud that, particularly as it relates to the greater pricing predictability and stability for the mailers that we represent. Think about this: There is nothing that disturbs a business person quite to the degree of unpredictability, certainly in their measured cost components, and as I indicated already, almost every one of our mailers representing our coalition spends at least 25 cents out of every dollar to Postal Service commissions.

Our customers don't want to hear about the issues that might be driving the Postal Service's difficulties, as they were in the 10 years leading up to this period of time. They really want to know that they are having rates that are certainly at the rate of inflation, at the maximum and under the rate of inflation and, at the same time, reasonably predictable because God knows there is enough unpredictability in the other aspects or forces of the business that we operate in.

There is a subject that I want to underscore for a moment because there is a lot of discussion about competitive versus non-competitive categories. I am not an economist. I don't proclaim to be one. But it seems to me that the issue of price elasticity is something that you don't have to be an economist to understand. It is a very simple concept that says demand is fundamentally affected by elasticity, and it is either elastic, which means it is highly responsive to price changes, or inelastic, which means it is not. I think one of the things that we need to consider here, and I refer you specifically to the testimony on page 5, which certainly dramatizes, as it relates to saturation mail, the extreme elasticity that exists. Let me be very specific, knowing that you are a very fact-based person and that your staff certainly is.

From the period of fiscal years 1988-96, an 8-year period of time, as you know, postal rates at that time were running around greatly in excess of rates of inflation, excessively so, as a matter of fact,

and our particular form of mail, which was at the time called third-class carrier route presort, now called ECR—enhanced carrier route—during that entire 10-year period of time actually had a one-tenth of 1 percent decline, which simply says that that type of business was being adversely affected by these price degrees.

In contrast, during the same period of time, First Class Mail went up 15 percent and noncarrier route mail went up 34 percent. So there is the negative side or the elastic side of downward pressure. Now why don't we contrast that with postal rate reclassification.

Since that period of time, and as you recall the specifics of that, it represented about a 2.7-percent decline, average rate decline, for this particular subclass. Interestingly, in the 2 years that have followed that, Mr. Chairman, there has actually been a 17-percent increase in volume. I would respectfully submit that that is about as dramatic evidence on the subject of price elasticity as one can possibly—it is almost textbook if you are going to write a book about it and express it in that fashion.

Clearly, the thing that makes this particular endeavor on your part so important to us, and as we look at the subject of price elasticity, and sensitivity and dynamics of the marketplace, deals with the subject of cost coverage. Our particular form of subclass, as I presume you know, involves a 203-percent markup, which means it is 103 percent higher than the costs attributed to this particular classification. You can contrast that number with the average for all postal products, which is 156 percent. So, mathematically, it is pretty clear that this particular form of mail is certainly carrying its fair share, if not unfair share, of the burden.

It is because of this sensitivity that the particular amendments or the particular aspects that you represent in this particular H.R. 22 appeal to us, but we would respectfully submit some suggestions in terms of improvements. Knowing you, Mr. Chairman, as much as I had a chance to sit in on the first day of these hearings, you specifically, and I think appropriately, said this is a work in progress. So to the degree this is a work in progress, we are going to take this opportunity to respectfully submit a couple of ideas that we would like you to seriously consider.

This talk about the freeze that the individual noncompetitive categories represent is a subject that we are particularly interested in calling to your attention. The best way to ensure fairness, and the strength of the saturation mail system, in our opinion, is ultimately to lower these high-cost coverages, as I mentioned before, borne by our mailers.

We understand, however, that the sensitivity of burdening others in the system with increases necessary to lower our cost coverages that is not palatable, and we realize that. Therefore, we are here today to advocate a method which our industry, or any other mail type for that matter, can earn in its own pricing rationalization and a manner that does not come at the expense of others.

As a point, in fact, Mr. Chairman, our proposal is a self-financing proposal with no cost shifting involved in it. Our proposed negotiated service agreement language would give the U.S. Postal Service the pricing freedom necessary to act decisively in a business en-

vironment, where a protracted rate process would cripple its ability to manage the postal mainstream efficiently.

The language prevents any contribution to overhead or any erosion of that and allows the customers to save by increased work share, but also by increased volume, as long as the total contribution is not lowered. NSA's are sunshined so that the public, mailers, and competitors are privy to the U.S. Postal Service's sanctioned discount.

Legislation clarifying the U.S. Postal Service's ability to use NSA's is needed even outside the context of H.R. 22, in our opinion. NSA's are an essential tool. As you know, they are an integral part of American business. Contract rates, volume contracts are very common. However, unlike the contract rates offered by private companies, the Postal Service NSA's would be subjected to non-discrimination requirements that is available in comparable terms. In other words, any mailer able and willing to meet the terms of an existing NSA would be able to participate, an important safeguard in our view.

H.R. 22 in its present form would allow the Postal Service to enter into NSA's with mailers in a noncompetitive category under strictly limited circumstances as to be of little use to either mailers or the Postal Service. The main problem with section 3641 requirement, from our point of view, mandating that NSA mail make a contribution to overhead cost that is "equal, on an average unit basis" to that of the most similar classification of mail. This "equal unit contribution" requirement and the requirement that mailers would have to undertake the additional mailing costs to earn a rate benefit would transform NSA's into an inferior form of traditional worksharing discounts from our point of view.

The only rate benefit for a mailer would be the amount of additional postal cost savings that the agreement generates. Yet unlike worksharing discounts, an NSA discount would impose the risk of liquidated damages if the mailer failed to perform as contracted. This lessens, in our view, the intended attractiveness of NSA's to mailers.

The bill's NSA provision should be expanded to permit NSA's that generate an equal or total dollar contribution to overhead costs. The principal concern raised about NSA's is that they might lead to rates that reduce the contribution of contracted mail to institutional costs, thereby burdening other mail or the postal system.

The bottom-line test should be that each agreement must not result in a loss of contribution to overhead cost that then must be borne by other forms of mail. Through NSA's, mailers can provide the Postal Service with guaranteed contributions to institutional costs while we grow profitable volumes that will benefit the overall financial health of the system and support universal service. Yes, there is no free-lunch proposal here. It is earned.

A second change needed to bring increased flexibility is to eliminate the prohibition of transferring products to the competitive category. H.R. 22, as currently drafted, would freeze the types of mail in the noncompetitive category that could be transferred to the competitive category based on the current scope of the Postal Service's legal monopoly. Therefore, if a product is covered by a monop-

oly, it would be forever barred from transfer to the competitive category, regardless of how competitive that category may become. Forever is a very long time indeed. This provision would nullify an important part of the pricing flexibility that this bill intends to bring about for competitive mail.

Consider the case of bulk First Class Mail. In the future, some bulk First Class Mail, such as billing statements, may become price sensitive and highly competitive due to changes in the communications technology or changes in the marketplace. As currently framed, the bill would not permit the U.S. Postal Service to respond to these significantly changed circumstances. It would risk losing that volume and its contribution to overhead costs.

If the mail were, in fact, competitive in a marketplace sense, the U.S. Postal Service should be authorized to transfer that mail to a competitive category. With this ability, the USPS could retain the volume or mitigate the losses in contribution through competitive pricing adjustments.

It is important that no statutory language prohibits the U.S. Postal Service's flexibility to respond to increasing dynamic market changes. The only statutory tests for transfer to the competitive category should be whether, in fact, it is competitive under marketplace standards.

In short, a greater flexibility is needed in classifying and pricing mail that faces intense or greatly intensified competition and market conditions in these terribly turbulent times.

As you know, Mr. Chairman, our testimony offers several others that I will not go into today. Suffice it to say, that the two discussed today are critical to the future of the saturation industry as a whole, to my company, to small businesses, to consumers nationwide, and to the health of the U.S. Postal Service and its vital mission to provide universal service.

With these modifications, your committee can report out a bill that we support with enthusiasm. It is laudable, Mr. Chairman, that you are working to reform and modernize the Postal Service in good times rather than trying to accomplish the much more difficult task of reform in times of economic stress.

In this permanent Whitewater economy of ours, it is quite wise, indeed, to follow the sage advice of Charles Handy in his remarkable book, "Age of Paradox." He said simply, "If it ain't broke, fix it anyway."

Yes, continuous improvements, sir, is the compelling mantra of this age for all of us. We look forward to supporting your efforts through the 106th Congress.

[The prepared statement of Mr. Kamerschen follows:]

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Verbal Testimony
of
Robert Kamerschen

On Behalf of the
Saturation Mailers Coalition

Before the
U.S. House of Representatives
Committee on Government Reform

Subcommittee on the Postal Service

March 4, 1999

Mr. Chairman and Members of the Subcommittee, I am Robert "Kam" Kamerschen, Chairman of the Board of ADVO, Inc. ADVO distributes targeted saturation shared mail advertising for more than 23,000 retail and service oriented businesses. Every week we reach consumers in approximately 60 million households nationwide. Most of our programs are distributed by mail; the remainder through private delivery.

I have over thirty years experience as a private sector executive, the last ten as ADVO's CEO. Previously, I was responsible for several Fortune 500 companies. I come before this Subcommittee as someone with significant experience in postal issues, and also as one who understands marketplace dynamics.

Today, I appear on behalf of the Saturation Mailers Coalition, an organization of more than 40 print advertising companies that include weekly community newspapers, shopper publications, enveloped coupon distributors, and shared mailers like ADVO. The saturation mail industry provides hundreds of thousands of small businesses and entrepreneurs an affordable means to advertise their products and services and a means to distribute billions of dollars in savings to consumers. In an era when advertising is increasingly focused on the more affluent consumer, we deliver savings to every segment of society including those who rely upon us to afford basic necessities like food and transportation. Not all consumers read newspapers or can afford a computer, but all consumers receive mail.

Although many of our members, like ADVO, use private delivery for part of their distribution, mail is the preferred distribution method because of its credibility and reliability in the eyes of consumers. While many traditional mail flows are evaporating, our product's popularity is growing. This presents the Postal Service with a critical opportunity to help sustain affordable universal service by growing revenue and volume from saturation mail. However, our products can only accomplish this if they are priced competitively with other alternatives outside the mailstream.

The Subcommittee's goal of modernizing the USPS, particularly through greater pricing predictability and stability, is important to the current and future success of all of our companies. The technological changes in the marketplace are revolutionary. To survive, the Postal Service must be able to adapt to change rather than be its victim. We applaud your efforts, Mr. Chairman, and the efforts of the ranking minority member and suggest specific ways we believe HR 22 can be improved to give the Postal Service greater flexibility to meet the needs of the future.

The members of our industry not only compete against each other, we also compete with advertising in daily newspapers and private delivery companies. The healthy competition between postal and non-postal distribution has stimulated the economy over the last two decades. It has fostered innovation and efficiency, spawned new products and services, and responded well to consumers who are hungrier than ever for information and savings.

This competition has made pricing flexibility crucial to the Postal Service's ability to attract and keep saturation mail volumes which have cost coverages of over 200% (100% over our direct cost), the highest cost coverage of any subclass in the system. The recent success of the new enhanced carrier route subclass dramatically illustrates that increases in volume and contribution to overhead cost flow from pricing that recognizes the price elasticity of saturation mail. However, traditional subsidies to the newspaper industry (ie: tax, labor and anti-trust) and the inability of the postal service to lower our cost coverage ratios to something approaching the system average of 156% endanger our ability to grow or even maintain current volumes. To the detriment of all mailers in the system, such high cost coverages could put the Postal Service in danger of losing one of its only growth areas.

As a result, our industry is counting on HR 22 to provide relief from this inequity. Unfortunately, the proposed price caps lock-in this unfair allocation of institutional costs. Our mail could well become captive to price increases that would trigger a volume death spiral. One that threatens the viability of the Postal Service.

Mr. Chairman, this freeze precludes the growth that is essential to the well-being of the Postal Service.

The best way to ensure fairness and the strength of the saturation mail stream is ultimately to lower the extremely high cost coverages borne by our mailers. We understand, however, the sensitivity of burdening others in the system with the increases necessary to lower our coverage ratios. Therefore, we are before you today to advocate a method by which our industry, or any other mail type, can earn its own pricing rationalization in a manner that does not come at the expense of other mailers.

Our proposed negotiated service agreement language would give the USPS the pricing freedom necessary to act decisively in a business environment where a protracted rate process would cripple its ability to manage the postal mainstream efficiently. The language prevents any erosion of contribution to overhead and allows customers to save by increased workshare or increased volume (as long as total contribution is not lowered). The NSAs are sunshined so that the public, other mailers and competitors are privy to any USPS sanctioned discount.

Legislation clarifying the USPS's ability to use NSAs is needed even outside the context of HR 22. NSAs are an essential tool. Virtually all American businesses offer contract rates to their customers. However, unlike contract rates offered by private companies, Postal Service NSAs would be subject to strict non-discrimination requirements. Any mailer able and willing to meet the terms of an existing NSA would be able to participate, an important safeguard.

HR 22 in its present form would allow the Postal Service to enter into NSAs with mailers in the non-competitive category under such strictly limited circumstances as to be of little use to either mailers or the Postal Service. The main problem is the Section 3641 requirement mandating that NSA mail make a contribution to overhead cost that is "equal, on an average unit basis" to that of the most similar classification of mail. This "equal unit contribution" requirement and the requirement that mailers would have to undertake additional mailing costs to earn a rate benefit

would transform NSAs into an inferior form of traditional “worksharing” discounts. The only rate benefit for a mailer would be the amount of additional postal cost savings that the agreement generates. Yet unlike worksharing discounts, an NSA discount would impose a risk of liquidated damages if the mailer fails to perform as contracted. This lessens the intended attractiveness of NSAs.

The bill’s NSA provision should be expanded to permit NSAs that generate an equal or greater total dollar contribution to overhead costs. The principal concern raised about NSAs is that they might lead to rates that reduce the contribution of contracted mail to institutional costs, thereby burdening other mail or the postal system. The bottom line test should be that each agreement must not result in a loss of contribution to overhead costs that must then be borne by other mail. Through NSAs, mailers can provide the Postal Service with guaranteed contributions to institutional cost while we grow profitable volumes that will benefit the overall financial health of the system and support universal service.

A second change needed to bring increased flexibility is to eliminate the prohibition on transferring products to the competitive category. HR 22, as currently drafted, would freeze the types of mail in the non-competitive category that could be transferred to the competitive category, based on the current scope of the Postal Service’s legal monopoly. Therefore, if a product is covered by the monopoly, it would be forever barred from transfer to the competitive category, regardless of how competitive that product may become. This provision would nullify an important part of the pricing flexibility that this bill intends to bring about for competitive mail.

Consider the case of bulk First Class mail. In the future, some bulk First Class mail (such as billing statements) may become price sensitive and highly competitive due to changes in communications technology or the marketplace. As currently framed, the bill would not permit the USPS to respond to those changed circumstances. It would risk losing that volume and its contribution to overhead costs. If the mail were, in fact, competitive in a marketplace sense, the

USPS should be authorized to transfer that mail to the competitive category. With this ability, the USPS could retain the volume or mitigate contribution losses through competitive pricing adjustments.

It is important that no statutory language prohibits the USPS's flexibility to respond to market changes. The only statutory test for transfer to the competitive category should be whether a product is, in fact, competitive under marketplace standards.

Mr. Chairman, my written testimony mentions a couple of other opportunities to make HR 22 stronger in its ability to deliver greater stability, predictability and flexibility to the modern Postal Service. The two discussed today are critical to the future of the saturation industry as a whole, to my company, to small businesses and consumers nationwide and to the health of the United States Postal Service and its mission to provide universal service. With these modifications, your committee can report out a bill that we can support with enthusiasm. It is laudable, Mr. Chairman, that you are working to reform the Postal Service in good times, rather than trying to accomplish the much more difficult task of reform in times of economic stress. We look forward to supporting your efforts through the 106th Congress.

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TESTIMONY OF
ROBERT "KAM" KAMERSCHEN
On Behalf Of The
SATURATION MAIL COALITION

Before The
SUBCOMMITTEE ON POSTAL SERVICE
Of The
COMMITTEE ON GOVERNMENT REFORM AND OVERSIGHT

UNITED STATES
HOUSE OF REPRESENTATIVES

March 4, 1999

TESTIMONY OF ROBERT "KAM" KAMERSCHEN
ON BEHALF OF THE SATURATION MAIL COALITION

INTRODUCTION

I am Robert "Kam" Kamerschen, Chairman of ADVO, Inc. Advo provides saturation shared mail advertising programs serving more than 23,000 retail and service businesses in markets throughout the country. Our programs are distributed to over 60 million households by mail and through private delivery. I am appearing on behalf of the Saturation Mail Coalition, an organization of more than 40 companies that provide saturation advertising programs throughout the nation.

The saturation advertising industry consists of weekly community newspapers, shopper publications, enveloped coupon distributors, and shared mailers like Advo. In total, the industry serves hundreds of thousands of mostly small businesses and individual entrepreneurs that have few if any affordable alternatives for distributing advertising messages to potential customers. Affordable saturation advertising is a lifeline that keeps them in business and enables them to grow. Saturation advertising also delivers valuable information and savings to consumers. In an era when advertising is increasingly focused on the more affluent consumers, our industry serves the needs of every socio-economic segment of society, including those who depend upon the values and savings in our advertising programs to meet their household budgets. Not all consumers have access to a newspaper or computer, but all consumers receive mail.

Although many Saturation Mail Coalition members, like Advo, use private delivery for part of their saturation advertising distribution, mail is the preferred means of distribution because of its credibility and reliability in the eyes of consumers. A viable postal system is essential because of the highly competitive nature of our industry. We compete not only among ourselves but with advertising distribution through daily newspapers (the dominant competitors in most markets) and private

delivery companies. This competition between postal and non-postal distribution has stimulated the economy over the last two decades. It has fostered innovation and efficiency, spawned new products and services, expanded the market, and forced all competitors to meet the needs of the local retail and service industries they serve.

The postal system has always been a vital part of the infrastructure of the American culture, commerce, and economy. Changing it through comprehensive legislation is a daunting task that presents both opportunities and risks. Postal reform legislation, as did the Postal Reorganization Act of 1970, will affect the course of the Postal Service for decades. Whatever else reform legislation does, it must ensure a healthy, viable Postal Service that can meet the nation's needs.

The Coalition endorses the objectives of postal reform to achieve greater postal rate stability, predictability, and flexibility. The provisions of H.R. 22 in large measure align with those objectives. The price cap mechanism, for example, holds the promise of more stable, predictable rates for mailers in the non-competitive category. However, price caps alone will not ensure that result if the Postal Service does not have sufficient pricing flexibility to respond to changing market conditions.

The Postal Service appears to be doing well at the present, but as a businessman, I know there is no room for complacency. Change in the marketplace is not only inevitable, it is intensifying in frequency and amplitude. Any business that is unwilling or unable to anticipate and adapt to change will fail. In my view, the Postal Service's biggest challenge is retaining its core volumes, or replenishing lost volumes, in the face of new electronic communications technologies and hard copy delivery competitors. If this challenge is not met, the losers will be the Postal Service, those mailers that have no effective alternatives, and most of all, the American public.

The Postal Service's ability to meet this challenge depends on having flexibility to respond to the inevitable marketplace changes. The litmus test of postal reform is whether it provides adequate flexibility for the Postal Service, while affording

reasonable safeguards against exploitation of monopoly users and competitors. I commend your efforts, Mr. Chairman, and the efforts of the Ranking Member, and I suggest the following changes that will improve H.R. 22, encouraging competition and allowing the Postal Service the flexibility it needs to meet the challenges of the future:

1. Allow Negotiated Service Agreements so long as they produce an equal or greater total dollar contribution to institutional costs.
2. Provide increased pricing flexibility within the Noncompetitive Category baskets (other than single-piece First Class Mail in Basket 1) by allowing limited rate bands around the rate caps, as proposed by the Postal Service.
3. Eliminate the prohibition on transferring products that are currently covered by the postal monopoly into the Competitive Category. The only test should be whether a product is in fact competitive, under marketplace standards.

These points are discussed more fully below.

I. Negotiated Service Agreements That Maintain Or Increase Total Dollar Contribution To Institutional Costs Should Be Allowed.

Contract rates and volume discounts are common in the business world, and are used by the Postal Service's competitors. Negotiated Service Agreements (NSAs), which would be subject to public disclosure and non-discrimination safeguards not applicable to private contracts, are an essential tool for the Postal Service. Properly structured, NSAs would enable the Postal Service to respond to market conditions, and to preserve or increase postal volumes and contributions, without detriment to other mailers.

H.R. 22 would allow the Postal Service to enter into NSAs with mailers in the non-competitive category, but under very limited circumstances that will be of little use to mailers or the Postal Service. The main problem is Section 3641's requirement that the NSA mail make a contribution to institutional costs that is "equal, on an average unit basis" to that of the most similar mail classification. This "equal unit contribution"

requirement would transform NSAs into an inferior form of traditional “worksharing” discounts. The only rate benefit for a mailer would be the amount of additional postal cost savings that the agreement causes, regardless of how much new volume and institutional cost contribution the agreement may generate. And, the mailer would have to incur additional preparation costs to achieve those savings. Yet unlike worksharing discounts, an NSA discount would impose the risk of liquidated damages if the mailer fails to perform as contracted. I believe that few mailers would be willing to undertake the additional costs and financial risks that this entails for the benefit of a worksharing-like discount.

The NSA provision should be expanded to permit NSAs that generate an equal or greater “total dollar contribution” to institutional costs. Such an increased contribution could be achieved by increased volumes, reduced costs, or a combination of the two. The principal concern raised about NSAs is that they might lead to rates that *reduce* the contribution of contracted mail to institutional costs, thereby burdening other mail or the postal system. This concern would be met by a requirement that the agreement not result in a loss of contribution to institutional costs.

With this modification, NSAs would be subject to the following requirements that fully protect the public interest:

1. NSAs must be made available to similarly situated mailers on substantially the same terms;
2. NSA agreements must be publicly available;
3. The mail under the agreement must cover its attributable costs;
4. In addition, the mail must generate either (i) an equal or greater total dollar contribution to institutional costs, or (ii) a unit contribution that is equal to or greater than that for the mail classification most similar to the mail under the agreement;
5. The mailer is subject to liquidated damages for failure to meet the terms of the agreement, including any minimum volume commitments or the institutional cost recovery requirement.

As a result of the above, the NSA will be “self financing” and will not burden other mailers.

The 1995 Reclassification Case (Docket MC95-1) is a good example of how rate reductions for certain mail can generate increased volumes and contributions to institutional costs. From FY 1988 to FY 1996, a period of substantial rate increases preceding reclassification, the volume of Third Class carrier route presort mail (now Enhanced Carrier Route mail) declined 0.1%, while non-carrier route volumes grew 34% and First Class volume grew 15%. As a result of reclassification, rates for Enhanced Carrier Route mail were reduced by an average of about 2.7 percent. Yet over the two fiscal years since reclassification, following nearly a decade of stagnant carrier route volumes, ECR volumes have grown nearly 17 percent – producing a significant increase in total dollar contribution to institutional costs. Our modification to the NSA provision would allow the Postal Service to achieve similar beneficial results without adverse impact on other mailers.

II. Rate Band Flexibility Is Needed Within The Non-Competitive Category.

H.R. 22 would lock in rate relationships for all mail in the “noncompetitive” category. All rates would move up in near lock step based on the annual CPI-based adjustment factor, with little freedom to adjust rate relationships that, over time, become out of sync with marketplace realities. The *marketplace* does not move in lock step, nor does it move with predictability; rate relationships that today seem reasonable will not remain so indefinitely.

This lack of flexibility is particularly troubling for the Enhanced Carrier Route (ECR) subclass of Standard A mail, a subclass that includes saturation mail used by the Coalition’s members. ECR mail is highly competitive and relatively price sensitive, and the saturation mail component of ECR is price elastic. Yet at current rates, ECR mail is assessed a 203% institutional cost coverage, or a 103% markup over costs – the *highest*

institutional cost coverage of any mail subclass. This is substantially higher than First Class Mail and other competitive products like Express Mail, Priority Mail, and Parcel Post. Within Standard A mail, which consists primarily of advertising mail, the higher-density, lower-cost, and more-price-sensitive ECR subclass is charged an institutional cost contribution substantially higher than that for the Regular (non-ECR) subclass, both on a percentage markup basis and on a per-piece contribution basis:

<u>Institutional Cost Contribution</u>	<u>Standard A ECR Subclass</u>	<u>Standard A Regular Subclass</u>	<u>ECR as a Percent of Regular</u>
Percentage Markup	103.0 %	34.6 %	+ 298 %
Per Piece Contribution	7.55 ¢	5.44 ¢	+ 39 %

Locking these rate relationships into place permanently is unfair, economically unsound, and counterproductive in the long run. Saturation mailers operate in a highly competitive environment. We cannot pay high postal rates that price us out of the market in competition with non-postal distributors like newspapers and private delivery companies. If rates for saturation mail do not reflect market realities, the Postal Service will lose that volume and overhead contribution — because mailers either go out of business or are forced to leave the mail and start up their own private delivery operations, transforming themselves from Postal Service customers into competitors.

This shift from mail to private delivery has already occurred in some of our markets. Just this January, Advo switched most of its mail in the Cincinnati market from postal delivery into our own private delivery operation. For the Postal Service, that shift represents an annual volume loss of 18 million pieces and more than \$2 million postage. We have also established private delivery operations in Philadelphia and Boston. In the aggregate, these private delivery operations have diverted more than 44 million pieces and cost the Postal Service over \$8 million in lost revenue annually. Many other saturation advertising companies also use private delivery for a

portion or all of their advertising distribution, as do many newspapers for their total market coverage saturation advertising programs.

The problems caused by freezing existing rate relationships are not confined to ECR mail. I believe that ECR mail will continue to be highly competitive and price sensitive, probably even more so than today. Perhaps some components of Standard A Regular mail will become more price sensitive. Perhaps segments of bulk First Class mail, such as billing statements, will become more price sensitive. Because no one knows what will happen in the marketplace, the Postal Service must have increased pricing flexibility within the non-competitive category to respond to marketplace changes with differential pricing adjustments.

The Postal Service's modest rate band proposal, with 2% downward flexibility and 1.5% upward flexibility around the price cap, makes sense and provides a modicum of critical pricing flexibility. We agree with the Postal Service that this pricing flexibility should apply at the basket level, not the subclass level.

III. Greater Flexibility Is Needed In Classifying And Pricing Mail That Faces Competition.

A. Competition Is Beneficial And Should Be Encouraged.

Postal Service competitors argue that any form of competition by the Postal Service is inherently bad. I disagree. Competition is inherently good. Competition fosters innovation and efficiency, and benefits mail users and all consumers by ensuring the greatest choices among competing alternatives in terms of both price and service. The goal should not be to eliminate the Postal Service as a competitor, but to maximize competition within reasonable boundaries that guard against abuse of the postal monopoly.

Some believe that a quasi-government entity, like the Postal Service, should never compete with private companies, or that there is something inherently "unfair"

about rates for competitive products that provide a less-than-average contribution compared to non-competitive products. But the concept of “fairness” cannot be divorced from economic and competitive marketplace realities. If competition is arbitrarily precluded, or if rates for competitive products are arbitrarily priced at a markup above what the marketplace will bear, the Postal Service will lose that volume and its institutional cost contribution. Rates for the remaining mail, even in the non-competitive category, will have to be increased. Everyone (except postal competitors who are insulated from competition) loses. Market-based rates for competitive mail are “fair” to all mailers in both an economic and a real sense.

Postal Rate Commissioner Ruth Goldway, in her February 11 testimony to the Committee, has correctly recognized the importance of maintaining beneficial competition, rather than *insulating competitors* from competition. After describing the benefits of competition, Commissioner Goldway stated that “Likewise, H.R. 22 should rely more on the advantages of competition than on protecting the marketplace from possible Postal Service competition.” Testimony at 1. She further observed that

“We should not curtail the ability of the Postal Service to be innovative just because of its size. As the Supreme Court has said, ‘[l]ow prices benefit consumers regardless of how those prices are set, and so long as they are above predatory levels, they do not threaten competition.’ Further, it has said, ‘[i]t is in the interest of competition to permit dominant firms to engage in vigorous competition, including price competition.’ ” *Id.* at 2, footnotes omitted.

Mailers in the non-competitive category have a stake in these issues. The bill technically separates non-competitive from competitive mail. But non-competitive mailers will be adversely affected by arbitrary prohibitions against transfer of products to the competitive category, or by an arbitrary markup pricing constraint on competitive mail that causes the Postal Service to lose competitive mail volumes and their contribution to institutional costs. Those institutional costs will have to be

recovered from the remaining non-competitive mailers, perhaps through an “exigent” rate increase.

Postal reform legislation should ensure that the Postal Service not abuse its monopoly by engaging in anticompetitive pricing against private competitors. In fact, the H.R. 22’s price cap mechanism for non-competitive products, particularly for single-piece First Class mail, provides the strongest form of protection against such abuse. It would prevent the Postal Service from raising the price of a First Class stamp above the CPI-based price cap in order to fund price reductions for competitive products. Coupled with the provisions requiring competitive mail to cover its costs and subjecting the Postal Service to the antitrust laws, this adequately protects against unfair competition.

B. The Prohibition On Transferring Products To The Competitive Category Should Be Eliminated.

Section 3764(b)(2) of H.R. 22 would freeze the types of mail in the non-competitive category that could be transferred to the competitive category, based on the scope of the letter monopoly. If a product is covered by the monopoly, it would be forever barred from transfer to the competitive category, regardless of how competitive it might become. This provision would effectively nullify the transfer provision of Section 3764, an important part of the supposed pricing flexibility for competitive mail.

Consider the case of bulk First Class mail. At some point in the future, there may be components of bulk First Class mail (such as billing statements) that, due to changes in communications technology or the marketplace, become price sensitive and highly competitive. Under the bill as currently framed, the Postal Service would be unable to respond to that changed circumstance. It would risk losing that volume, and its contribution to institutional costs. If the mail were, in fact, “competitive” in the marketplace sense, then the Postal Service should be authorized to transfer that mail to the competitive category. It would then have the opportunity to retain that volume or

mitigate losses through pricing adjustments. Retaining some volume, and its contribution to institutional costs, is a better choice than risking the loss of everything.

There should be no statutory prohibitions on the types of mail that may be transferred between the noncompetitive and competitive categories. The only statutory test for transfer to the competitive category should be whether a product is, in fact, competitive (under marketplace standards), not whether it technically falls within the scope of the statutory monopoly.

Mr. Chairman, on behalf of the Saturation Mail Coalition, I thank you for your efforts to modernize the Postal Service. With the above modifications that enhance the ability of H.R. 22 to create greater stability, predictability and flexibility in a modernized Postal Service, we can support your bill. I would add that in an era of volatile economic and marketplace changes greater than any in our nation's history, it is laudable that you are working to reform the Postal Service in relatively good times, rather than waiting for a crisis that would make the task of reform much more difficult and perhaps too late.

Mr. MCHUGH. Thank you very much. My mechanic must have read that book. [Laughter.]

I think your testimony, taken in total, and everyone I assume in this room understands, as I mentioned in the beginning, the varied interests that you represent really poses a great juxtaposition against the previous panel.

Lest anyone comes away from this hearing believing that my sole interest in entering this process was to level the playing field, I felt it was equally important, perhaps, frankly, with my rural perspective, somewhat more important to try to do what we can to ensure that there is a U.S. Postal Service into tomorrow that will continue to deliver mail to Box 863, Piermont Manor, NY, 13674, at a price that whoever wanted to mail me can afford and can rely upon.

Over the short term, and maybe my horizons are not far-reaching enough, I think that can only be the U.S. Postal Service. I think you folks would agree with that, even though you understand, if not in some of your instances, represent some of the true giants of the private sector.

Let me begin by asking you to respond to what Mr. Kelly said on the previous panel about his view that the first meaningful step in true reform has to be, in his opinion, the total end of the current first class monopoly, letter mail monopoly.

How do you think, if at all, that monopoly cessation might affect the services that you utilize through the U.S. Postal Service?

Kam, if you want to go first, you have got the microphone.

Mr. KAMERSCHEN. I guess I do. In this era of 800-pound gorillas, which we just followed, we will respectfully submit our point of view on that.

The thing I like that this committee is doing a lot is that you are proactively trying to shape the future of the U.S. Postal Service, and in its past, the Postal Service itself has not been as absolutely proactive on that score. Although I have to tell you that, in the last 5 years, I think those of us dealing with the Postal Service have seen a truly remarkable change, one that far exceeded what we would have anticipated, a far more customer-focused, market-driven enterprise, one that views the reality of what it is, which is a quasi-public, quasi-private institution.

On the one hand, it has got the very appropriate burden of universal service, and on the other hand it has got the very appropriate challenge of financing that universal service. I am always amused when the word "profits" is used by some of the outsiders of this industry because, by definition, as you know, they are not supposed to make a profit. They are supposed to finance the continuation of the various services they have.

This premise of competitiveness is quite changing. Whatever was viewed for competitiveness when the Founding Fathers—I guess it was Ben Franklin who was the first Postmaster General—put this together, that was a long time ago. We are entering the 21st century. There are fundamental realities that have changed. Indeed, the mailstream and sources of revenue by the Postal Service are getting attacked from all fronts, including electronically, as well as marketplace.

Consequently, I, a free-trade guy by background and conviction, see the challenge that the Postal Service has in trying to satisfy

all of these independent wants and needs. My view is very simple because I think it is the view of certainly what I represent and, hopefully, what all of the other folks in this room represent. All of us need a Postal Service, and it needs to grow in order to finance this infrastructure requirement.

And, therefore, I take the view that we should think outside the box in terms of allowing the Postal Service to seek revenue sources, be more competitive, all, however, within the understandable limitations of antidiscrimination and all of the rest of it.

Mr. MCHUGH. Thank you.

Neal.

Mr. DENTON. Thank you, Mr. Chairman.

I almost feel as though, when it comes to the question of whether or not we should support the letter monopoly or not, I should agree with the comments of Lewis Sachs from the first panel on this subject. [Laughter.]

I think I find myself disagreeing with Mr. Kelly. His point of view on that is different from my constituents who see the strength of a national mail delivery network resting on the back of the letter mail monopoly.

I smiled when I heard the one quote, "Fix it, even if it isn't broke." I don't think that particular piece of the 1970 act is something that my constituents would be interested in seeing us tinker with at this point. It is not that broke, and it is not something I think we ought to be looking at doing, as H.R. 22 does not.

Mr. MCHUGH. Mr. Cerasale.

Mr. CERASALE. I don't think that we are ready to see what the consequences are for elimination of the letter monopoly. And I think Mr. Kelly, especially in his oral presentation today, discussed the idea that the Postal Service should limit itself and be limited in looking to delivery of letter mail.

One of the fears that we see is that we have heard numbers 25 to 50 percent of first class mailstream is made up of something to do with remittance, a bill, a dunning letter, the check coming back. A good deal of that product is already under competition from other sources. So we see a significant peril to the underpinnings of the First Class Mail, on which we all depend. So I don't think we need to cut it out now. We need to try and move forward and allow the Postal Service some opportunities to try and shore it up.

Mr. MCHUGH. Thank you all. Let me just ask a few questions that are based on your testimonies, and some of the suggestions, some of the concerns that you did raise. Jerry, you mentioned, what I believe I recall correctly, your opinion that a baseline case should not contain contingency and prior year losses, which obviously we agree with—

Mr. CERASALE. Yes.

Mr. MCHUGH [continuing]. And I agree with. But then you say, similarly, you felt that if a rate case were held any time within a year of the assumed baseline case that the rate case should prevail, true?

Mr. CERASALE. Yes; I did.

Mr. MCHUGH. First of all, first quick question, why do you think that is important?

Mr. CERASALE. I think it is important to start off right away with some Rate Commission rate. So I think if a case the Commission has gone through has been in effect for—comes through and been in effect for about a year, to go through the entire process again and the delay of that, we probably would be beyond what the contingency and prior year losses are. So our view would be let us get started and let us get going right away.

Additionally, there are costs to having a rate case, and we could avoid those if it is within that short period of time.

Mr. MCHUGH. So the assumption you are making is that, and I left this unsaid, and for those who may not be aware, obviously, in a rate case, contingency and prior year losses are included—

Mr. CERASALE. Yes.

Mr. MCHUGH. As they would not be in the baseline.

Mr. CERASALE. That is correct.

Mr. MCHUGH. You feel the cost, both financially and probably emotionally, too, given what some of you folks endure, of a rate case, of doing another essential rate case, a baseline case, would be too high, and you would be willing to accept the inclusion of the contingency and prior year losses.

Mr. CERASALE. Yes.

Mr. MCHUGH. Let me follow up before you answer that. What concerns me, and what I am interested to know because I am sure you thought of it, is that a big concern, I think if we were to put that into the bill, I think the logical outcome is it would certainly be very tempting for the Postal Service to say, "OK. Let's file a rate case" within a year because they know that they then would be assured of prior year losses and contingency. I am assuming you made that calculation and, therefore, you say, "Well, it may be, but given all other factors, we are willing to accept that." Am I correct in what I read?

Mr. CERASALE. You are correct. I don't think any of us believe that a base case will come out with lower rates overall.

Mr. MCHUGH. Neal.

Mr. DENTON. If I could comment on that.

It is so rare when I disagree with Jerry Cerasale on anything.
[Laughter.]

Mr. MCHUGH. I am going to give you a chance in a minute more, so go ahead.

Mr. DENTON. I agree with the concept in H.R. 22 of allowing for a separate—a "mother of all rate cases" is what we would ultimately get out of this, I think. I speak not just for my organization, but for every attorney sitting behind me here that is involved in rate case litigation. I am not an attorney.

We are concerned that not only would it carry on the prior year losses, which are dwindling more and more now all of the time, and that would lock that in forever, and the contingency, and you bring both of those up, and they are not included in H.R. 22. But I think some of our folks are also fascinated with the notion that this "mother of all rate cases" will be conducted with the Postal Rate Commission having these new authorities, having new subpoena authority.

A lot of the problems that have frustrated us in these last few cases are problems that were alluded to by the second panel of gen-

tlemen; that the Postal Service is good at obfuscating and disguising data. It is a curiosity, when you have the U.S. Postal Service generating every bit of data used in a postal rate case. You have the U.S. Postal Service massaging every bit of data used in a postal rate case. You have them parsing it out in little, bitty pieces as they see fit in a postal rate case.

I like the notion of going into a full-blown final rate case knowing that the Postal Rate Commission will have the kind of subpoena authority that is outlined in H.R. 22.

Mr. MCHUGH. Thank you. As you just said, Neal, you and Jerry so rarely disagree that we don't want to pass up an opportunity to—you don't have a disagreement. You have a difference of opinion.

One of you believes, Neal, although I think it is fair to say you have still concerns of the unknown, that the concept of rate caps with the band in place in H.R. 22 meets most. I am not asking you to start whistling, you know, "Blue Bird on My Shoulder" here—

Mr. DENTON. We won't, don't worry.

Mr. MCHUGH. I didn't think so. But meets most of your concerns. Whereas, Jerry feels, as you heard him in his verbal testimony, and it is in his written testimony as well, obviously, that the Postal Service needs more flexibility.

So I will pose it this way: Neal, why don't you turn to your friend, Jerry, and tell him why he shouldn't be so troubled by this.

Mr. DENTON. As we began this process many years ago, the nonprofit community was as far away from agreeing with the notion of giving the Postal Service greater freedom and flexibility than the gentleman who sat in this seat before I sat down here.

We have, over the many years, recognized some problems in the way that the Postal Service applies the preferred rate intent of the law to nonprofit rates. We see it now. We see it continually. I mentioned at the end of my testimony here, we see some problems with the enforcement of the eligibility restrictions.

Someone used to tell me, "just because you are paranoid, doesn't mean that they are still not out to get you." Nonprofit mailers are concerned about what could happen in an unfettered, free rate-setting environment if the Postal Service were able to get their hands on the preferred postal rate without the oversight of the Postal Rate Commission.

What is built into the caps and the bands is the kind of protection that I think our folks need in order to be fully supportive of that freedom of flexibility. Those are the restrictions that, while Jerry would describe them as being too constrictive for nonprofit mailers, we would describe them as being protective, to prevent the type of situation that, frankly, we are living with now as a result of this last rate case; these January 10 increases, where the first class rate went up 1 cent, and the nonprofit standard A rate went up 3 cents, where commercial rate mailers are enjoying 3- and 4-percent rate increases and nonprofit charities and churches are looking at 15- to 18-percent or higher increases.

We believe that the caps and bands type of arrangements, as described in H.R. 22, would prevent us from having to recognize that in the future.

Mr. MCHUGH. Jerry, are you persuaded? Or turn to your friend, Neal, and say, "Neal, here is why you should be more concerned."

Mr. CERASALE. Right. I will do that.

I am not persuaded, but this line of questioning hits the area where in my testimony I say we have some several opinions on how to do things.

I think as we look at the application of the bands in H.R. 22, it goes down to the rate category level, we think. But the real key is that, in order to have any rate go above the index that is established, you must, in a year just prior to it, have that rate rise less than the index by a similar amount, thereby making the band really coming out to being just what the index is. And, therefore, some adjustments, those that Kam would say that their cost coverage is a little bit too high and maybe the Postal Service should be able to adjust for market purposes, it kind of puts a restraint on them.

There are a couple of ways to look at some changes in how you would effect those bands. One is, you could establish the basket, which I think get to Neal's fifth basket there, the basket, and have the index apply to the basket. And underneath the basket every rate cell, basically, would be set within the bands, the 2 percent up, 2 percent down, above or below the index. That is one way of looking at it. And I think, from Neal's perspective on basket five, that is the problem he saw with standard A and publication mail being connected together.

Another way to look at this would be to have the index apply to each subclass separately within the basket. I mean, I think a basket always has to be there so that it doesn't go above whatever the index is, but you can apply the index to each subclass, and then underneath it the rate categories can go above or below the index, the 2 percent. That would protect his subclasses of standard A and publication mail within a separate basket which, if the nonprofits agree with that, we have no problem establishing, from the Coalition's point of view, agreeing with the nonprofits to make a separate basket for them.

I think another factor to, I think, cover one thing that H.R. 22 does, to try and not allow someone to constantly get an increase way above the index every year, which is why you had the saving provision in there, you might, another thought would be to put in a requirement that no rate could go above the CPI, which is different from the index, so that you can keep an inflation kind of cap or index on everyone, but still allow some flexibility for the Postal Service, in the noncompetitive classes, to make adjustments to the marketplace that aren't quite as constrained and rigid as those that appear right in H.R. 22.

Mr. MCHUGH. Well, good. We have got a deal.

Mr. KAMERSCHEN. Do I get to cast the deciding vote? [Laughter.]

Mr. MCHUGH. Sure.

Mr. KAMERSCHEN. Not really.

Look, the subject it is hard not to agree with some of the points on both sides. If we got, like Mr. Smith, if we got our druthers, obviously—our particular Coalition—we would like to examine what Jerry just described as this modest increase in cost coverage difference of 203 percent versus 156. His idea of mathematics are different than mine, but so be it.

We, as you know, support the price cap concept. We would have submitted a version, but, frankly, the Postal Service beat us to it in terms of a proposed amendment. We have the very simple point of view that the price caps and the bands allow certainly directionally the stability and the predictability that we talked about earlier, but at the same time, a kind of disregard to the economic realities of the marketplace that say, gee, at any given point in time, isn't there some plus or minus modification of those bands to allow the Postal Service the flexibility to protect volumes, build volumes or what have you.

So, we would support the plus or minus variations of the bands and, second, we would support the notion of treating that on a basket basis as opposed to a subclass basis. This, in our view, is a modicum of flexibility for the Postal Service which is really a modicum of flexibility for the mailers that I represent.

[Additional questions for the record follow:]

Neal Denton-Non Profit Mailers

- 1. As you know, Congress has received a huge volume of mail from various nonprofit groups across the country asking for Congress to change the recent rate increase nonprofits were hit with on January 10, 1999. How does H.R. 22 help you or hurt you in this regard?**
- 2. Do you know whether the PRC heard any testimony sponsored by either the postal service or the various organizations of nonprofit mailers that discussed the rate design anomaly in the initial postal service request for increases in rates for nonprofit periodicals? (R97-1)**



April 6, 1999

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Consumers Union of U.S., Inc.

Vice President
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American Lung Association

Executive Director
Neal Denton

The Honorable John H. McHugh
Chairman
Subcommittee on the Postal Service
B 349-C Rayburn House Office Building
Washington, DC 20515

Dear Mr. Chairman:

Thank you for the opportunity to add to the record of the most recent hearings on HR 22. We are pleased to respond to Mr. Fattah's thoughtful questions and stand ready to assist the Subcommittee as you continue to refine the Postal Modernization Act.

1. HR 22 does not affect the rates imposed upon nonprofits as a result of the most recent rate case, R97-1. However, the Alliance of Nonprofit Mailers is currently in litigation before the US Court of Appeals over the legality of the increases. For nonprofit mailers seeking a rollback in the current rates (excluding the anomaly in periodical rates discussed below), the Alliance appeal offers the best prospects.

HR 22 does offer some important protections that may prevent some types of unfair treatment foisted on consumers, particularly nonprofit mailers, in future rate proceedings:

- The bill creates a fair system of a rate increase "cap" and 2% "bands" that would protect nonprofits (and other mailers) from being "singled-out" by the USPS for especially damaging rate increases (as in Docket R97-1).
- The bill would protect mailers from "above the cap" increases in consecutive periods. That is, the USPS could not "pile on" a series of CPI+2% increases year after year.
- In response to our concerns, the bill would also change the language mandating that nonprofit overhead (*i.e.*, institutional) costs remain at 50% to read "no greater than 50%." Both the USPS and the PRC have told us that this provision likely would have mitigated the R97-1 increases on nonprofit mailers. [Section 202(i)]
- The bill also offers an important safeguard to prevent the USPS from attributing more costs to nonprofit mail than to commercial rate mail with identical

1 Denton Responses 4/6/99

characteristics. Although the costs attributed to nonprofit mail are still well below this threshold, the Postal Service has reported unexplained and disproportionately high cost increases for the nonprofit subclass. The language in the bill is another safeguard to prevent tampering with preferred rates in the future. [Section 201, 3722]

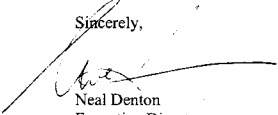
- The revision also contains language crafted by the Alliance to ensure the authorization of nonprofit Periodicals (second-class) "requester" publication status. Presently, nonprofit publications must only mail to a list of subscribers, whereas regular periodical publications can mail to unpaid "requesters." Such a correction would allow for greater dissemination of educational material and for greater contributions to USPS institutional costs. [Section 215]

2. As far as I know, the rate design anomaly that has been the topic of much recent conversation between nonprofit mailers, the USPS, the PRC and the Subcommittee was not identified until after the new rate structure was implemented. No party testified to or offered any discussion of the anomaly during the 1997-1998 proceedings before the Postal Rate Commission.

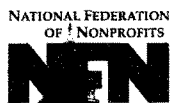
We have been very pleased with the rapid action taken by the Subcommittee and by the USPS and the PRC to resolve this unintended anomaly as quickly as possible. And while we remain hopeful that a more permanent solution can be crafted that will allow nonprofits to enjoy a preferred periodicals postal rate, we welcome the USPS/PRC short-term remedy that has been communicated to the Subcommittee.

Again, we thank you for this opportunity to add to the record. Please feel free to call upon us if we may be of further service.

Sincerely,


Neal Denton
Executive Director

cc: The Honorable Chaka Fattah, Ranking Minority Member



*"Advocating for Nonprofits
in Postal, Regulatory,
Legislative, and Accountability
Issues Since 1982"*

March 22, 1999

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Nancy Noble
*International Fund
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Eric Wentworth
*Council for Advancement
and Support of Education*
Peter Yoder
Indiana University Alumni Association

EXECUTIVE DIRECTOR

Lee M. Cassidy

Hon. John M. McHugh, Chairman
Subcommittee on Postal Service
U.S. House of Representatives
349 B Rayburn House Office Building
Washington, DC 20515

Dear Chairman McHugh:

Thank you for your note of March 16, in which you ask for additional comments on questions which arose during your hearings on H.R. 22. I'm pleased to have the opportunity to expand my comments, as follows:

1. Question: Is there any good reason that you are aware of why the Postal Service doesn't allow the *Elks Magazine* to use the lower Regular rates?

It is my understanding that the Domestic Mail Classification Schedule does not allow issue-by-issue switching between Nonprofit and regular rates for Nonprofit Periodicals. It is my further understanding that a Periodical publication could switch to regular rate status upon application and approval, but would have to remain in that status indefinitely, and perhaps permanently.

Recent conversations with the Postal Service indicate that the Service will propose a one-time switch to commercial status, without penalty, but the election would have to remain for the current rate cycle (until rates are next changed). I believe the only difference between that proffered option and the present situation is that the application process would be eliminated. With that option, nonprofits would be at risk whenever their advertising percentage in any issue fell below 10 percent. Currently, if the advertising portion of a Nonprofit Periodical is less than 10 percent, the advertising is carried at the postage rate for editorial matters; as a regular-rate mailer, all advertising is charged the postage rate for advertising, which is the same rate for both Nonprofit and regular rate Periodicals.

There is another issue at work here. The reason nonprofits pay the same postage rate for advertising matter as do Regular rate Periodicals is that Congress intended to discourage significant amounts of advertising in Nonprofit Periodicals. Thus, the incentive to restrict advertising to 10 percent or less. But the *Elks* have computed that the overall cost would be less, at the Nonprofit rate, if they carried 39.5 percent advertising or more. So the rates paid are in violation of Congressional intent.

An immediate "fix" would be to permit Nonprofit Periodicals to switch from Nonprofit to Regular rates, issue by issue, to gain the lower rate. But

the Postal Service has told me that they have "software problems" with that situation. The Postal Service created the problem and I believe they should be required to fix it, but the only solution will be to reduce nonprofit rates to the same percentage of increases as was assigned to regular rate mailers.

2. Question: Are you proposing that these publications should have rates that might not be high enough to cover their costs? Please explain.

My testimony points out that, numerous times in the past, the Postal Service has demonstrated its inability accurately to measure costs. The Postal Rate Commission agreed that the Postal Service was inaccurate in its measurement of Nonprofit costs in the 97-1 rate case. The only question was whether the inaccuracy was large or small. I believe the situation in which the Elks Magazine and the other magazine mailer found themselves is not anomalous, but one of many in which the rates paid are higher than anticipated by the USPS and the PRC, and higher than actual costs warrant.

We have reported to you separately that virtually all reported Standard A mailings of which we have become aware, made by fairly large and certainly sophisticated mailers, have paid increases in the 11-17 percent range, while the "average" has been reported to 9.6 percent. But it beggars common sense that large mailers would pay increases almost double the rate anticipated, and the average actually be the forecast percentage.

The short answer to the question is that we believe the current rates are much higher than needed to cover actual costs.

3. Question: Is it true that one of the reasons for the anomalous nonprofit Periodicals rates is that the PRC attempted to minimize the impact of cost-based rate increases by imposing small institutional cost burdens on both Regular and Nonprofit Periodicals?

It is my understanding that the institutional cost charge to Regular rate Periodicals coming out of the last rate case was 1 percent, and the resulting charge to Nonprofits was .5 percent. But the amount paid for Periodicals postage is the result of a complex calculation that includes the amount of advertising and the distance each individual copy travels. If that results in huge anomalies, it demonstrates that something serious is wrong with the ratemaking process, at least in this case. Congressional policy has long been that nonprofit rates should be lower than regular rates, not higher, and I believe the unwritten understand of the Revenue Forgone Reform Act was that they would be much more than 1.66 percent lower, as is the case for the first Elderhostel mailing of 1999.

4. The following question was offered for any witness to reply to: Do you believe that the bill should include some periodic re-calibration of rates to realign costs and prevent excessive shifting of overhead burdens among products?

As I suggested in response to a follow-up question during the hearings, there is a need to have a re-cast Postal Regulatory Commission in place before changing the rate-setting mechanism. As is the case with so much utility de-regulation over the last 20 years, an established regulatory commission has supervised de-regulation. But H.R. 22 would put de-regulation of the Postal Service in the hands of the Postal Service.

It is critical that the baseline rates be accurate, if indexed rates are to be fair. Only a strengthened PRC can assure that adequate information has been obtained from the Postal Service, examined, and its accuracy certified. Then, baseline rates can be considered fair and accurate.

In the out years, it would be necessary to periodically re-calibrate rates to prevent excessive shifting of overhead burdens among products. Every five years should suffice. But the tone of the question helps make my overall point: costs for all classes of mail should, if accurately measured, increase at roughly the same percentage each year. If costs appear to be on a roller coaster, it almost certainly reflects not increasing and decreasing costs, but inaccurate measurement.

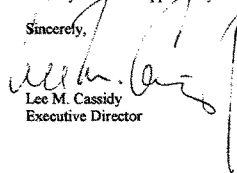
The Postal Service admitted that in the Mail Classification case in 1996, when it proposed elimination of the Classroom Rate, because of inability to get an accurate fix on costs.

I also would like to comment on Question 2., posed to John Sturm of the Newspaper Association of America: Do you think current rates would be more equitable if the PRC had the authority now to require the Postal Service to gather necessary data?

In the R 97-1 case, all four sitting Commissioners (not just the Chairman) asked the Postal Service to delay the case for a short time to update what were clearly inaccurate and out-of-date data. The Postal Service curtly refused. Any other regulatory commission in the country would have had the authority to order better data, and to recess the process until it was produced.

Thank you for this opportunity to more completely state my views.

Sincerely,



Lee M. Cassidy
Executive Director



Robert "Kam" Kamerschen
Chairman of the Board

Hon. John M. McHugh
Chairman
Subcommittee on the Postal Service
B-349C Rayburn House Office Building
Washington, DC 20515

April 1, 1999

Dear Mr. Chairman:

I am pleased to respond to your letter of March 16, 1999, and provide you with the answers to the three questions posed by the Subcommittee's Ranking Minority Member, Rep. Chaka Fattah.

Please feel free to contact me at any time should you or any of the subcommittee members have additional questions about our testimony before the subcommittee.

Again, thank you for the opportunity to testify on HR 22 on behalf of the Saturation Mailers Coalition.

Sincerely,

A handwritten signature in black ink that reads "Kam".

Robert Kamerschen

Robert "Kam" Kamerschen, Saturation Mailers

1. Your testimony states that the only statutory test for transferring a product to the competitive category should be whether it is, in fact, competitive under marketplace standards, not whether it technically falls within the scope of the statutory monopoly. Do you anticipate that all, or mostly all, of the saturation mail currently sent by Advo and the other companies in the Coalition would be transferred to the competitive category under your recommended test?
2. Do you believe that many, or most, of the mailers in your coalition will be able to qualify for NSA's by having sufficient additional volumes of mail at reduced rates to produce an equal or greater total dollar contribution to the postal service's overhead costs?
3. You would retain a provision providing for the liquidated damages for failures to meet the terms of a NSA. The postal service has suggested the elimination of any such provision. What is your opinion concerning the removal of that provision from current legislation?

Robert "Kam" Kamerschen - Saturation Mailers Coalition

- 1) Your testimony states that the only statutory test for transferring a product to the competitive category should be whether it is, in fact, competitive under marketplace standards, not whether it technically falls within the scope of the statutory monopoly. Do you anticipate that all, or mostly all, of the saturation mail currently sent by ADVO and the other companies in the Coalition would be transferred to the competitive category under your recommended test?

I have learned that one should never anticipate what may come out of the regulatory process. Saturation mail should be eligible for consideration for transfer, given what, I believe, is the competitive nature of the market for saturation advertising. Whether it would be transferred would depend on a determination by the Postal Service that such competition, in fact, exists.

- 2) Do you believe that many, or most, of the mailers in your coalition will be able to qualify for NSA's by having sufficient additional volumes of mail at reduced rates to produce an equal or greater total dollar contribution to the Postal Services overhead costs?

I don't know. The ability to generate sufficient new volumes to produce an equal or greater contribution will vary from mailer to mailer depending on competitive circumstances in the marketplace. I cannot say with certainty even that ADVO "will be able to qualify" for NSA's. First, NSA's are not risk-free for mailers. They would face liquidated damages or negotiated penalties for non-performance. Second, if the transaction costs for obtaining PRC approval are too high, mailers may be deterred from entering into NSA's. Our NSA amendment would give the parties flexibility to pursue mutually beneficial agreements that protect against any loss in contribution and provide an incentive to generate volume growth and new revenue streams over which to spread the increasing cost of the Postal Service's universal service obligation.

- 3) You would retain a provision providing for the liquidated damages for failures to meet the terms of a NSA. The Postal Service has suggested the elimination of any such provision. What is your opinion concerning the removal of that provision from current legislation?

Although we favor a provision that ensures that neither the Postal Service nor any other mailer will be worse off because of an agreement, we are, however, concerned that HR 22's liquidated damages provision could be unnecessarily harsh, especially in the case of a minor breach of an agreement.

Mr. MCHUGH. Thank you, gentlemen.

We have a fourth panel coming up, and they have been very patient for quite some time. So I don't want to impose upon them any longer.

I want to thank you all for not just your appearance here today, but your active participation in this process, as I know you have experienced in the past. We are going to look at all of the things that you have stated, both for the record here today, and suggestions that we have talked about and that you wrote about in your statements, and try to do the best we can in continuing what I am now beginning to wonder is maybe a work in process, not progress, but we are moving along the calendar. So thank you, gentlemen. I appreciate it.

Mr. CERASALE. Thank you for your 4 years of working on this.

Mr. MCHUGH. It beats prison. [Laughter.]

Mr. KAMERSCHEN. Barely.

Mr. MCHUGH. Barely, but it beats it. [Laughter.]

Our final panel and, again, I appreciate their patience, is comprised of a very diverse group. First, the executive director of the Main Street Coalition for Postal Fairness, John T.—also known as Jack—Estes, who is accompanied by John F. Sturm, who is representing the Newspaper Association of America, and Lee Cassidy, National Federation of Nonprofits, and Joe Roos, the Associated Church Press—I hope we have enough chairs for all of these good people—and David Stover, Esq., from the Greeting Card Association, and Guy Wendler from the American Business Press, and Kenneth B. Allen of the National Newspaper Association and, finally, Charmaine Fennie, who is chairperson of the Coalition Against Unfair USPS Competition.

Folks, I tell you what, please, before you all get settled, there are so many. Why don't you please stand, and if you will raise your right hands.

[Witnesses sworn.]

Mr. MCHUGH. The record will show half the room responded in the affirmative. [Laughter.]

Which included all of the witnesses.

Jack needs to be seated because he will be one of two of all of you who are actually presenting oral testimony. I believe I am correct all of the rest of you submitted written testimony. I recall reading a lot of testimony, and I think the number matches the people at the table, and I appreciate the work that went into that.

Also, Ms. Fennie will be presenting as well. I believe I am correct on that. Is that true? Robert tells me I am correct.

So, Jack, thank you for being here. And, again, it bears repeating. Thank you for your patience. It has been a long day, and you are very gracious in still remaining with us. We are looking forward to your comments. So, sir, you may proceed.

STATEMENTS OF JOHN T. ESTES, EXECUTIVE DIRECTOR, MAIN STREET COALITION FOR POSTAL FAIRNESS, ACCOMPANIED BY JOHN F. STURM, NEWSPAPER ASSOCIATION OF AMERICA; LEE CASSIDY, NATIONAL FOUNDATION; DAVID STOVER, THE GREETING CARD ASSOCIATION; GUY WENDLER, AMERICAN BUSINESS PRESS; KENNETH B. ALLEN, NATIONAL NEWSPAPER ASSOCIATION; AND CHARMAINE FENNIE, CHAIRPERSON, COALITION AGAINST UNFAIR USPS COMPETITION

Mr. ESTES. Thank you, Mr. Chairman. I am relatively hesitant to start out this way, but I must beg your indulgence. I was just informed before the hearing started that Joe Roos, from the Church Press, took ill and will not be here.

I am under oath, and I can assure you he is not with Mr. Sachs. In fact, he is not even near the Treasury Department. [Laughter.]

Mr. MCHUGH. That latter bit of news is good. We appreciate that. The former, of course, is not, and we hope that it is nothing serious and that he recovers quickly.

Mr. ESTES. I don't believe it is. He got word to me that he just couldn't be here, and he was sick. If it is OK, he would like to submit a short statement for the record, and I told him I would ask.

Mr. MCHUGH. Absolutely. It will be submitted into the record, and we will review that, of course, and wish him our best for recovery.

Mr. ESTES. Thank you.

Mr. Chairman, in spite of your tireless efforts to improve postal reform and the Postal Service, both now and in the future, and in spite of our appreciation for advancing concepts which have forced all of us to look very carefully at what we believe to be the most precious aspect of the Postal Service; namely, the preservation of universal service, and in that regard, to put aside, in many cases, narrow self-interests and look at the broader national interests, and in spite of our appreciation for working with a truly professional, courteous, accessible staff, and I mean that in every sense of the word, in spite of all of those things, Mr. Chairman, we are unable to support H.R. 22 in the form in which it is introduced.

We have come to that conclusion, as I am sure you know, not lightly. We have worked hard and long, not probably as hard and long as you have—probably few have in that regard. But we have asked ourselves a few key questions about why we have come to this conclusion.

Really, the first one was whether or not, in our judgment, the Postal Service is destined to become obsolete in the near future. And our answer to that is, of course, no, but it will undergo some structural changes.

We have asked ourselves whether the Postal Service will be unable to achieve its primary goal of providing universal service, and will it continue to provide such service. And our answer to that is, yes, again, even if there are some structural changes.

And, finally, Mr. Chairman, we have asked if there is clearly currently no clear and present danger now threatening the Postal Service from fulfilling its mission, even though there may be some clouds on the horizon, should we nevertheless start to implement plans to anticipate a bumpy road? And our answer to that, sir, is, yes, we should.

As I am sure you have noted in our statement to you, Mr. Chairman, we divided our position into really three categories. We listed, first of all, those areas where we thought we could move ahead now promptly with some of the reforms you have suggested. And without going into detail, those included the Postal Regulatory Commission reforms, the evaluation of the labor and management relations situation, relaxing some of the Treasury Department finance proposals—many of those, really, we looked at in the Cochran bill in the other body—and nailing down some of the Board of Directors' qualifications.

But more importantly, and probably the meat of what we are presenting to you is that, for reasons discussed in our statement, it may be that there are other areas that need to be recast and that there needs to be some evidence that it should be present—the evidence should be present before we pursue them, and we listed those. Again, those were the ratemaking price caps, the baseline rate case, rate flexibility for noncompetitive products and market tests.

Now, I said evidence, and obviously you are probably thinking, well, what more evidence could you possibly want or need or think would be desirable? The evidence that we are really looking for, Mr. Chairman, is evidence of true, harmful, immediate or potential competition. What type of competition? Is it e-mail? Is it electronic diversion? How serious is it? What classes does it affect? Is there truly out there today a serious concern that there is evidence of that type of competition that could seriously harm and perhaps, in some cases, disable the Postal Service? We think more work needs to be done in that area, and that is why we have taken the position that some of these areas need to be looked at carefully, and in some cases, maybe, as we have suggested, the provisions of the bill need to be recast.

And then, last, Mr. Chairman, we have suggested that some of the reforms which you have proposed should be set aside, certainly for now, and that included testimony you have received earlier today on the USPS Corp. We do not believe negotiated service agreements are in the public interest, and we would hope that that would be set aside. And, of course, we are concerned about the bifurcation of the first class basket.

So having said all of that, Mr. Chairman, our basic line really, our bottom line, is that there may be reasons to go ahead in some areas, but we do not believe that the bill has addressed some of the urgent needs that need to be justified before some of the provisions that should be enacted. It may not be an emergency, but there certainly should be an urgency.

We think H.R. 22, Mr. Chairman, is cast in more of a predicting-the-future mode, and it really should be in cast in a planning-for-the-future mode. We are very aware that it is highly desirable to gather and evaluate the evidence and that we have urged you to do. We are also very aware that you are probably unquestionably, as stated, today, have no interest apparently in moving ahead with additional hearings.

There are concepts in this bill, Mr. Chairman, which we find confusing, complex, difficult, based on, as I have said, evidence that we are not convinced is a matter of record. So we would hope that

we could look—and one of the problems we are really struggling with, Mr. Chairman, is the implementation of some of these concepts. It is one thing to put it in a statute, as you well know. It is another thing to struggle with the implementation, and therein lies some real problems.

I appreciate very much your agreement to have us assemble our “dream team” and come before you with an ability, hopefully, to respond to your questions. And at the appropriate time, I trust that “the team” would be able to react to whatever you have to say.

[The prepared statement of Mr. Estes follows:]



Main Street Coalition for Postal Fairness

John T. Estes
Executive Director

MEMBERS

American Bankers Association
American Business Press
Cahners Publishing Company
Coalition of Religious Press
Associations
Greeting Card Association
Hallmark Cards, Inc.
Miller Freeman, Inc.
National Consumers League
National Federation of Nonprofits
National Newspaper Association
National Rural Electric
Cooperative Association
Newspaper Association of America
PennWell Publishing Company
Penton Publishing Company
Tribune Company

Testimony of
John T. Estes
on behalf of the
The Main Street Coalition
Before the
Subcommittee on the Postal Service
U.S. House of Representatives

March 4, 1999

Chairman McHugh, members of the Committee on Government Reform, Subcommittee on the Postal Service, on behalf of the Main Street Coalition for Postal Fairness, thank you for this opportunity to submit our comments on H.R. 22, the Postal Modernization Act of 1999. We are customers of the Postal Service who represent more than 40% of its annual volume and mail in the First, Periodical and Standard classes. My name is John T. Estes and I am the Executive Director of the Coalition. Main Street members accompanying me today are my colleagues John Sturm, President and CEO of the Newspaper Association of America; Joe Roos, Executive Director of the Associated Church Press; Lee Cassidy, Executive Director of the National Federation of Nonprofits; Guy Wendler, President of Stamats Communications, Inc. representing American Business Press; and David Stover, Esq. representing the Greeting Card Association.

Main Street members share the **COMMON GOALS** of striving for a Postal Service that is first a public service, offering fair and affordable rates, providing universal service, committed to frequent and timely delivery and which is structured to preserve and foster a viable, productive, efficient and stable agency. In working for these common goals, we share **UNIFYING THEMES** to resist any bias favoring large mailers, insist on Postal Service management policies that protect those with no other alternative mailing choice and make the content of the mail the primary standard on which postal rates and timely service are based. These goals and themes we believe are confronted with **THREATS** from the ruinous impact which would result from an ongoing effort by some to weaken the Postal Rate Commission, and encourage discriminatory rates. To us these

goals, themes and threats are not platitudes, but rather the basis of our unity and the standard by which we judge the many provisions of this complicated Bill.

As you have stated, as recently as last Fall when H.R. 22 was reported out of your Subcommittee, this legislation should be considered as a work in progress. We concur with your assessment because under your leadership there has been a lot of work and significant progress. Main Street has over a number of months been a part of this process and, we think, a useful part. From our standpoint the provisions of H.R. 22 generally fall into three broad categories:

First, those proposals in the Bill that appear to need little or no modification and which should be implemented in the near future. These would advance the effectiveness of the Postal Service and its efficiency in accomplishing its mission; Second, those proposals which are not necessary or desirable on the basis of what we know now and in the form in which they appear - but which might, if they were recast or if clear evidence of need were forthcoming, deserve support; and Third, reform proposals which would not be appropriate and should simply be dropped.

We would like to preface those comments, however, by stating a shared concern. Do circumstances justify these extensive proposed reforms? H.R. 22 is based on the assertion that the Postal Service is or shortly will be in trouble, and that declining volume due to an inability to effectively respond to new and emerging competitive innovations in methods of communication, will in turn severely compromise the USPS mission in years to come. This theory would surely strike fear into the hearts of many. Recognizing,

however, that the bulk of the revenue and volume come from First and Standard Mail

(A), what are the facts (based on the 1998 USPS annual report) ?

Year 1998

<u>Class</u>	<u>Volume</u>	<u>Revenue</u>
First	Up 1.5 %	Up 1.8%
Std Mail (A)	Up 7.3 %	Up 6.8%
Priority	Up 9.0 %	Up 7.6%
Std Mail (B)	Dwn 1.7 %	Dwn 0.1%
Periodical	Dwn 0.9 %	Up 0.2 %

The above USPS analysis, which is representative of recent trends in prior years, provides no evidence that the house is on fire. But to justify the substantial - sometimes drastic - proposals in the Bill we must conclude that there is substantial, credible and persuasive evidence that there will be a fire. The record, however, reveals no such evidence. We often hear the warning that it would be unwise to wait until the Postal Service is broken to fix it. But without evidence of present or imminent "breakage" - such as declining volume or revenue trend lines over a representative period of time - demands for changes of the nature proposed in HR. 22 rest on little more than conjecture.

This cautionary concern is raised here to emphasize the danger of being swept up by the momentum of far reaching reforms without continually reviewing the basis on which such reforms should rest. We do not believe that the case for drastic change has yet been made. It must be made, if the broad mailing public is to be expected to support a reform bill that leans so far in the direction of deregulation. We do not disagree that support for some of the other more extensive reform proposals could emerge if it can be

established convincingly that a postal service crises for the public is approaching or will approach fairly soon. We do not question that efforts to improve the efficiency and effectiveness of the Postal Service should be an ongoing objective.

Major reforms of large public institutions need not and perhaps should not be attempted at one time barring an emergency. On the other hand phased in structural improvements would minimize the danger of economic or cultural dislocation inherent in abrupt changes in an institution affecting nearly every citizen.

Set out below are Main Street's comments on the three major categories mentioned above. This presentation does not cover every provision of H.R. 22. Those provisions not reviewed here should not be deemed immediately desirable.

Category One: Immediate Desirable Reforms

POSTAL REGULATORY COMMISSION The new Postal Regulatory Commission with effective subpoena authority and the power to require meaningful reports on costs and service would benefit mail users substantially. The policy of a strong Commission with expanded jurisdiction and subpoena authority is long over due for enactment.

LABOR MANAGEMENT RELATIONS Addressing labor management issues by utilizing the expert services of an outside agency should lead to an arms length evaluation of this area. This review should include the operational as well as the more strictly labor-relations effects of any propose reforms.

FINANCIAL MANAGEMENT Relaxing restrictions on Postal Service banking procedures should aid the USPS in developing a more responsive financial management procedure.

DIRECTORS QUALIFICATIONS Nailing down precise and meaningful qualifications for USPS Directors is a reform which should be immediately put in place. It has been suggested that candidates have a wide variety of skills and experience which is a qualification for diversity that Main Street endorses.

Category Two: Changes Whose Desirability Is Yet To Be Established

RATEMAKING UNDER PRICE CAPS We will not discuss here the theoretical issues involving implementation of a price cap system other than our concern about the lack of bona fide residual claimants (not Postal Service employees, but rather outside investors) and the consequent absence of motivation for effective performance. This suggests that notwithstanding its possible application in other industries, price-cap ratemaking may be unsuitable for the USPS. In line with this basic concern, we note that we are unaware of any of the private sector outside economic experts who have testified on this issue (in this or any prior Congress) who have endorsed price cap ratemaking for the Postal Service. The entire price cap system is aimed at de-coupling rates from costs. While the desire to move away from a cost based ratemaking system is certainly, in theory, an appropriate regulatory objective for some industries, we find troubling this current lack of endorsement for a postal price cap scheme, which is one of the linchpins of the Bill. Price caps, because they do depart from close examination of costs, have the potential to become price escalators rather than as a means of controlling prices, (at least for captive traffic) - especially where the regulated firm faces only limited competition. Moreover, in the case of noncompetitive statutory monopoly services, we are concerned that price caps can lead to service reductions rather than to cost reductions. For a price cap to be effective there must be little or no opportunity for the regulated concern to escape its

discipline. That is not true here and that should be corrected. In addition, we refer to what appears to be an astonishing exemption to the price cap discipline with respect to union and non-union employees of the Postal Service. Such an exemption, if true, has by itself the potential of destroying the discipline essential for a meaningful price cap system. This needs clarification.

Baseline Rate Case This proceeding is essential for a meaningful price cap regimen and it should be reinstituted periodically as a tune up proceeding to account for changes in the economy as well as in Postal Service circumstances and the varying costs of different types of mail. The USPS proposal to forego any such proceeding at any time is totally without merit and should be rejected out of hand.

Product Baskets There is no justification for dividing First Class letters into two baskets, which we refer to in our Category Three below. In addition the legitimacy of proposing product baskets at all requires additional evaluation under the concepts proposed in H.R. 22. Where there is no distinction in purpose or content of the mail, there should be no distinction in the way rates are set under the current system of rate making, or under one based on price cap techniques.

Rate Flexibility for Noncompetitive Products Under current law, the PRC plays a crucial role in checking any tendency of the Postal Service favoring some customers over others. Particularly the very biggest mailers over the smaller ones. Allowing the Postal Service to make rate decisions, and not the PRC, gives rate setting discretion to the wrong party, legitimizes the idea of favoring one customer over another in the area of noncompetitive rates and should be avoided. In addition, the Bill creates a system of raising or lowering noncompetitive rates on a product by product basis, yet contains no definition of a

product. One interpretation of the Bill is that a product is a subclass or one level below a subclass, but the lines of demarcation that are drawn in that case are not clear. For example, Periodicals are a class and regular rate Periodicals are a subclass, but it is unclear what if any products, as referred to in the Bill, would come within that subclass. There are thousands of periodical rate combinations and Standard mail rate combinations that exist. Under the proposal is each to be considered a product? This is important because it is the pivot on which the rate setting mechanism turns. In other words how much the mailer will pay, or not pay, as the case may be. In a similar vein, we are very concerned that unless clarified, this rate flexibility mechanism would permit rate discrimination within a basket for various types of mail in that basket. The potential for such discrimination must be corrected.

Market Tests The proposal to sanction Postal Service market tests on a largely deregulated basis, up to \$10 million and in some cases \$100 million per test is unwise. In any event it should never exceed \$10 million, which under some circumstances could also be excessive. For competitive products, a specific market test would not even have to cover its costs. While one could debate whether such a provision protects the postal system overall, it is clear that such a provision provides no protection to a local business (large or small) that is on the receiving end of a USPS test of a competitive product. In weighing the public interest, Congress has a responsibility to consider not only the well-being of large mailers, national competitors, and the postal system as whole, but also the interests and well-being of local businesses who would have to compete against companies for whom the Postal Service has created a special "market test". The Postal

Service should not be in the business of helping one company "beat" another in the market place.

The above areas should be reviewed before proposing implementation. As noted, the house is not on fire and there is time to make sure this complicated package of reforms has the best possible chance of attracting widespread public support.

Category Three: Undesirable Reforms

Negotiated Service Agreements (NSA) This provision in the Bill allowing users of monopoly and other noncompetitive products to enter into contracts with the USPS for tailored favorable rates and other terms should be dropped. Such a procedure strikes at the heart of the confidence the citizen mailer has developed in the open, fair and public procedure employed in the ratemaking process by the PRC. Allowing the Postal Service to tailor an individual rate for one company necessarily means that it can favor one company over another that is not exactly similarly situated, but whose mail has close but not identical cost saving characteristics. The Postal Service is a public service organization which should provide delivery services equally for the benefit of all mailers. The principle of equal rates for equal service should be the guiding theme in providing noncompetitive services. Special deals should not be allowed. Several years ago when this volume discount bilateral contract rate reduction approach was advanced by the Postal Service, a major justification was that competitive pressures demanded immediate action in order for the Postal Service to compete with the private sector. This rationale, by definition, does not apply to noncompetitive products and thus there should be no NSAs for noncompetitive products. One of the major disadvantages of NSAs is the

potential they have for discriminatory rates. We remain unsatisfied that issue has been solved and urge that this proposal be dropped.

First Class Product Baskets As noted above there is a strongly held view that the entire concept of product baskets should be considered in our Category Three. Clearly, however, as related to First Class, the concept should be scrapped as inconsistent with the long established case that mail groupings - and the related differences in institutional costs - are to be separated only when and if the mail groupings concerned differ as to the purpose for which they are sent, the type of sender and the content of the mail. These criteria for establishing mail groupings for assignment of costs are consistent with the goal of maximizing the social benefits the Postal Service confers. It is that social benefit that justifies the Postal Service letter monopoly. Also it should be the basis for decisions regarding recovery of institutional costs, whose recovery is essentially a form of tax and as such should respect the policy behind the monopoly.

The USPS Corporation It is not as a general rule sound public policy for a government agency to compete with the private sector. The corporation would clearly be perceived as the alter ego of the Service. It would distract managerial effort and attention from the core responsibilities of the USPS. As such, it represents not only a departure from traditional Postal Service activity, without a showing that the public good would be served. This is truly a radical proposal and it is even more disturbing since other than at this late date there is no public record examining this proposal. At the very least, exhaustive hearings and an in depth evaluation would be required. Since this has not occurred it should be excised from the Bill at this time. Accordingly, an in depth analysis now of the other far reaching provisions of this portion of the Bill would in our judgment.

be premature. As a general rule, however, we would associate ourselves with the comments of Mr. Gleiman, Chairman of the Postal Rate Commission, before you on February 11, 1999. If for no other reason, this proposal in order to maintain public confidence, calls out for greater public dialogue.

USPS PROPOSALS

In his remarks before you several weeks ago the Postmaster General indicated there are two choices before us...let the USPS die or permit regular universal service to continue. As noted above, Main Street has absolutely no desire to see the demise of the Postal Service and every interest in preserving universal delivery of mail at affordable and non-discriminatory rates by the Postal Service. We are confident that you, Mr. Chairman, and other Members of your Subcommittee share this view. The Postmaster General expressed concern about some competitive postal products and potential foreign government invasion of the domestic USPS market when he appeared before you. Even so, we were not left with the impression, of an immediate pressing crisis, that would preclude further inquiry and require immediate legislation.

In our view the USPS proposals (a) contain excessive cost allocation flexibility so that competitive mail rates would be linked to Postal Service judgmental accounting practices which could lead to pricing products below cost rather than based on a factual analysis, (b) favor mail classes in the competitive category at the expense of the noncompetitive category and, (c) as a general rule seeks to increase the Postal Service's discretion to design, market, and price its products unilaterally independent of meaningful PRC oversight - and potentially to the neglect of its vital universal service obligation.

We refer specially to Postal Service proposals regarding the price cap which would destroy the incentive for improved productive efficiency by linking price cap application to internally incurred costs; the critical definition of a "product" within a class of mail; phasing out the effort in H.R. 22 to guard against loading of unfair proportions of institutional costs onto noncompetitive products in order to reduce competitive product rates, compounded by the discriminatory treatment of purchased transportation between competitive and noncompetitive categories; and the overall effort to reduce public access to information about USPS costs and transactions.

In general, the USPS proposals if adopted would move many of the reform principles advanced in H.R. 22 from our Category Two above to Category Three.

Conclusion

Where do we go from here?. Some will undoubtedly say four years is ample time for consideration of this legislation and we should finish the job now. However, Mr. Chairman, in our judgment we should continue to move ahead under your leadership with a focused program of Postal Service improvement. We believe that you should advance those proposals which enjoy wide spread support and simultaneously refine and revise the others in an effort to gain greater public understanding and support.

Mr. MCHUGH. Thank you very much. Some dream. [Laughter.]

I appreciate your comments, and we are going to hold to the practice of going to Ms. Fennie and allow her to make her statement and then—the reason we swore all of you in is that, clearly, in the Q&A we are not just allowing, we are interested in the comments that any or all of you may have.

So, with that, Charmaine Fennie, as I mentioned before, is the chairperson of the Coalition Against Unfair USPS Competition.

Welcome. Thank you for being here, and our attention is yours.

Ms. FENNIE. Thank you, Mr. Chairman, and members of the subcommittee. Thank you for the opportunity to be here today.

I am Charmaine Fennie, chairman of the Coalition Against Unfair USPS Competition, and the Coalition strongly supports passage of H.R. 22 with certain changes. The Coalition represents the interests of more than 12,000 privately owned small businesses in all 435 congressional districts, including 10,000 mail and parcel centers and 2,000 independently owned office supply stores. These businesses exemplify small business at its best.

We feel that H.R. 22 represents the best effort at comprehensive postal reform. However, there are important changes that we feel need to be made. We feel that we must see elimination of the Private Law Corp. for prohibition against competition with small businesses. The need for a Private Law Corp. has not been proven. No compelling case for authorizing the Postal Service to begin complete and unfettered competition with the private sector has been made.

The powers of the PLC are extraordinary. It can go into any business it wants, invest in any private company, and enter into joint ventures with any private corporation and could become a Fortune 500 company. The PLC can purchase any of our members or any of their stores. The Coalition opposes Congress authorizing a Government-owned corporation that can compete with our industry or purchase our stores.

The Postal Service instituted its smallest rate case in a generation last January, 1 cent for First Class Mail. That rate hike is expected to generate an additional \$1 billion in revenue annually. What would the PLC have to do to match this \$1 billion in revenue? It would have to turn itself into a business, such as Merrill Lynch. The largest publicly traded brokerage house had a 1997 profit of \$1.8 billion on gross revenues of \$31.73 billion and was No. 24 on the Fortune 500 list; or Sears, 1997 earnings of \$41.36 billion, a profit of \$1.18 billion, and it was No. 16 on the Fortune 500; or Motorola, No. 29, on the Fortune 500, with 1997 profits of \$1.18 billion on earnings of \$29.79 billion.

Mr. Chairman, the record of the USPS in private business ventures is terrible. In 1997, the GAO reported an \$84.7 million loss on these new ventures. Even if the USPS were to turn its poor record completely around and make an \$84.7 million profit, it would have to increase that profit by 1,200 percent to reach \$1 billion. H.R. 22 should firmly direct the Postal Service to not compete with private business in new, nontraditional ventures.

The Coalition respectfully requests that H.R. 198, the Postal Service Core Business Act be included in H.R. 22. H.R. 198 firmly states that the Postal Service is to return to its core mission of de-

livering postal services and not be distracted by the new, nonpostal ventures. Another version of this legislation has been proposed by the Mail Advertising Service Association.

Packing is one of the principal product lines for the mail and packaging members of the Coalition, and the Coalition does not believe that the Postal Service should be in the packaging business. The Postal Service estimates it will generate only \$13 million annually on packaging. This profit will only be realized by charging no advertising revenue to the Service.

Considering that the Postal Service's multi-million-dollar advertising budget, this seems very unlikely. This \$13 million is barely 1 percent of the \$1 billion generated by the 1-cent rate hike. The Postal Service would become the largest single packaging service provider with over 7,000 locations. It would offer packaging in most congressional districts represented by subcommittee members, including Philadelphia, Cleveland, Indianapolis, Brooklyn and Chicago.

The Postal Service stated during the PRC proceeding that it would only offer packaging where it felt it could make a profit. This means only urban and suburban areas, where the private sector is already providing the service. The Coalition is unalterably opposed to the Postal Service providing packaging in competition with its members and requests the subcommittee to adopt language which would prevent the Postal Service from offering this service in direct competition with Coalition members.

I would like to thank you, again, for the opportunity to testify. We feel H.R. 22 is very important to our members, and we urge action on the bill and these amendments as quickly as possible. It is our hope that this bill can be passed this year, so the implementation of postal reform can begin quickly.

Thank you.

[The prepared statement of Ms. Fennie follows:]

**TESTIMONY OF COALITION AGAINST UNFAIR USPS COMPETITION
BEFORE THE
HOUSE POSTAL SERVICE SUBCOMMITTEE
MARCH 4, 1999**

Mr. Chairman, Members of the Subcommittee, thank you for the opportunity to testify today. My name is Charmaine Fennie and I am chair of the Coalition Against Unfair USPS Competition. The Coalition strongly supports passage of H.R. 22 with certain changes detailed below. It is vitally important that Congress address the many issues which confront the U.S. Postal Service.

The Coalition represents the interests of more than 12,000 privately-owned small businesses in all 50 states and 435 congressional districts. These businesses include the 10,000 mail and packaging stores which operate under the franchises and independent names with which you are familiar including Mail Boxes Etc., Pak Mail, Parcel Plus, PostNet, Postal Annex+ and the independent stores of Associated Mail and Parcel Centers. Additionally, the Coalition represents the 2,000 independently owned office supply stores of the National Office Products Association. Our store owners invest their own capital and work to achieve the American dream. In virtually every instance, they are in their stores daily behind the counter servicing their customers. These businesses exemplify small business at its best.

As I said, it is vitally important that H.R. 22 becomes law. The issue of postal reform is crucial to the members of our Coalition. We have carefully examined H.R. 22 and believe it represents the best effort at comprehensive postal reform. However, there are some very important changes that need to be made. My testimony will outline these changes in detail. Our support of H.R. 22 is dependent on these changes being made. We believe the bill, in its current

form, does not adequately protect our small-business owners from predatory practices by the Postal Service.

Proposed Changes to H.R. 22

1. Elimination of the Private Law Corporation/Prohibition Against

Competition with Small Businesses in Nontraditional Areas: At the last hearing, Postal Rate Commission Chairman Ed Gleiman testified regarding many of the problems with the Private Law Corporation. The Coalition agrees with this testimony and echoes the concerns of Chairman Gleiman. **The need for a Private Law Corporation has not been proven. Neither the Postal Service nor any other advocate has stated a compelling case for authorizing the Postal Service to begin complete and unfettered competition with the private sector in any and all businesses and trades.**

The powers of the Private Law Corporation (PLC) are extraordinary because they are the powers of any other corporation under American law. That is to say, the PLC can go into any business it wants, invest in any private company, and enter into joint ventures with any private corporation. What does this mean?

a. The PLC can become a major Fortune 500 corporation or enter into a joint venture with any corporation such as General Motors, General Electric, AT&T, WalMart, or Microsoft.

b. The PLC can purchase any of our members or their stores. The Coalition opposes Congress authorizing a government-owned corporation that can compete with our industry or purchase our stores. The PLC would be unlike any other government chartered/corporation such as the U.S. Enrichment Corporation, COMSAT, Fannie Mac, or Freddie Mac - all of which were

created for a specific purpose which the private sector could not provide.

What happens to the profits, if any, of the PLC? There is no obligation of the PLC to provide any financial support to the USPS. **In fact, it can be expected that the PLC will not provide any significant revenues to the USPS since a new and growing corporation would naturally use its profits to grow its revenues or pay bonuses to its top management.** What good does this do for the American people as ratepayers or owners of the PLC? Since the stock of the PLC is owned by the USPS, no American can sell that stock to realize any benefit from the PLC. Neither can the ratepayer expect any relief from the threat of rising postal rates.

The Postal Service instituted its smallest rate hike in a generation last January, one cent for first class mail. That rate hike is expected to generate an additional \$1 billion in revenue. What would the PLC have to do to match this \$1 billion revenue contribution to the USPS? It would have to turn itself into businesses such as the following:

- **Merrill Lynch** - The largest publicly traded brokerage house in the country had a 1997 profit of \$1.8 billion on gross revenues of \$31.73 billion and was listed as #24 on the Fortune 500. With profits like these, the PLC could plow half its profits back into its business or pay bonuses to its management. The remaining half, nearly \$1 billion, could prevent a one-cent rate hike.
- **Sears Roebuck** - The venerable retailer reported 1997 earning of \$41.36 billion, a profit of \$1.18 billion and was listed as #16 on the Fortune 500. One billion dollars could support stamp prices leaving a relatively paltry \$180 million for reinvestment and bonuses for management.
- **Motorola** - The well-known electronics firm was listed as #29 on the Fortune 500. It reported 1997 profits of \$1.18 billion on earnings of \$29.79 billion dollars.

The point of this analysis is to show how difficult it will be for the PLC to be anything but a major competitor with American business if it's mission is to support stamp prices and

universal service. It is hard to make money in American business, and it is particularly hard to make billions of dollars in profits. Is it really the intent of H.R. 22 that the PLC become a wholly owned subsidiary of the Postal Service and strive to be one of the largest companies in America? If the PLC does not make billions of dollars in profits which can be turned over to the USPS to support stamp prices, what purpose has it served?

Mr. Chairman, the record of the USPS in private business ventures does not support such an assumption. In 1997, the General Accounting Office reported an \$84.7 million loss on these new ventures. **Even if the USPS were to turn its poor record completely around and make it an \$84.7 million profit, it would have to increase that profit by 1200 percent to reach \$1 billion.** A copy of the GAO report is attached for the record.

The evidence shows that the PLC cannot be a success. Congress should not create it in this or any other bill regarding postal reform. Instead, H.R. 22 should firmly direct the Postal Service not to compete with private business in new, nontraditional ventures. The Coalition respectfully requests that a provision such as H.R. 198, the Postal Service Core Business Act introduced by Representatives Hunter and Cunningham, be included in H.R. 22. H.R. 198 firmly states that the Postal Service is to return to its core business of delivering postal services, and not allow itself to be distracted by the new, non-postal ventures. Another version of this kind of legislation has been proposed by the Mail Advertising Service Association. Either of these approaches would send the correct message to the Postal Service and close the door on these ill-advised ventures into nontraditional activities.

Mr. Chairman, this issue of defining the mission of the Postal Service is vitally important. For the last few years, the Postal Service has been seeking to transform itself from the Postal

Service to some other type of entity. This is a mistake. The Postal Service has presented no viable plan for its new ventures and its track record is miserable. The mere threat of this huge federal agency being able to compete with congressional authority is very threatening to our small businesses. The Postal Service can spend millions of dollars in a series of failing while damaging to small business at the same time.

For example, the repetitive packaging service which the Postal Service proposes would involve nearly 7,000 locations and generate about \$70 million in total revenue. While a small amount by Postal Service standards, it is huge by the standards of our industry. **In less than two years, the Postal Service intends to become the largest single enterprise engaging in packaging and compete with nearly 70% of the locations of an industry which has taken nearly 25 years to establish itself. There is no question that such a program would do tremendous damage to the small businesses in our industry.**

Mr. Chairman, H.R. 22 must include a provision which will specifically state that the Postal Service must not engage in this kind of competition against small business. The Coalition respectfully requests that H.R. 198, the MASA amendment, or some other form of definite rules which require the Postal Service to concentrate on its core business of delivering the mail on a universal service basis be included in H.R. 22. The Postal Service cannot be allowed to compete with small business.

Regulation of CMRAs

Our industry is based on a close working relationship with the Postal Service. We act as Commercial Mail Receiving Agents (CMRAs) for many of our customers who rent private mail

boxes to receive their mail at our stores. This has historically been a positive relationship, with CMRAs working closely with local postmasters. However, in the past few years, the relationship has become strained. In July 1997, the Postal Service published a set of proposed federal regulations for CMRAs without any consultation or notification to our industry. With the exception of actual publication in the Federal Register, there was no notice to our industry and the comment period closed after only 30 days. This was not sufficient time for our small businesses to respond to the rulemaking process. The regulations included many negative new rules including a provision allowing a postmaster to terminate delivery and pickup of mail to a CMRA with no hearing or due process.

After great effort on the part of our industry and with the assistance of the Chairmen for the Full Committee, the Subcommittee, and other members of Congress, the Postal Service reopened the comment period for another 30 days. However, the USPS chose the single busiest time of the year for our industry - November 24 to December 24, 1997. Nevertheless, our industry geared up and responded with over 50,000 letters in opposition to the proposed CMRA regulations. Our members had to compose detailed comments while working 12-14 hours a day, packaging items to be in the mail for the holidays. The regulations are still pending. This fact pattern is recited to emphasize how the Postal Service can use its regulatory power to harass and harm those it regulates and with which it competes.

This dual regulatory/competitive issue is one which H.R. 22 has dealt with in Section 404a. The Coalition endorses Section 404a and requests specific direction to the Postal Service that this section covers the currently pending proposed federal regulations which would create a tremendous competitive disadvantage for CMRAs. The Postal Service should be directed by this

Subcommittee to scrap these proposed CMRA regulations. If there is a need for a revised regulatory framework for the CMRA/Postal Service relationship, it should not be established in an atmosphere of confrontation. The Coalition would be happy to work with the Postal Service on such an endeavor. The Coalition will submit proposed Committee Report language on this matter and requests that this report language be included in the Committee Report.

Status of Packaging

Packaging is one of the principal product lines for the mail and packaging members of the Coalition. In 1994, the Postal Service began a trial packaging service named Pack & Send in about 250 locations in seven states including California, Florida, Alaska, and Texas. The Postal Service did not request a recommended decision from the Postal Rate Commission prior to this service. The Coalition was formed in 1995 over this matter and began its efforts to oppose the direct competition of the Postal Service in one of its members' key product lines.

Over the last four years, the Coalition has fought a hard battle on this issue with the Postal Service at the Postal Rate Commission. First, the Coalition filed a complaint that alleged an illegal postal service being offered without a PRC rate proceeding. After winning this case, a rate proceeding was held at the PRC and a proposed recommended decision from the PRC is now pending before the Postal Service Board of Governors. At this point, the Postal Service has not yet begun packaging, thanks to the PRC ratemaking process.

The Coalition does not believe that the Postal Service should be in the packaging business. The Postal Service estimates it will generate about \$13 million annually on packaging, but the Coalition believes it will be far less. This "profit" will only be realized by charging no

advertising revenues to the service and only if completely successful. The Postal Service stated in the proceeding that it intended to provide no advertising except an on-site display. Considering the Postal Service's multimillion dollar advertising budget, this seems very unlikely. This \$13 million is barely one percent of the \$1 billion generated by the one cent rate hike.

As stated previously, the Postal Service will become the largest single packaging service provider by the end of the second year of its experiment. Attached for the record is a copy of 3,500 of the 7,000 zip codes in which the Postal Service proposes to offer packaging. It will offer packaging in most congressional districts represented by Subcommittee members including Philadelphia, Cleveland, Indianapolis, Brooklyn & Chicago, but not in the Chairman's district.

The Postal Service stated during the proceeding that it would only offer packaging where it felt it could make a profit. This means urban and suburban areas where the private sector is already providing the service.

Packaging would be one of the few postal products not offered on a universal basis. In fact, this concept provides the worst of both worlds for the ratepayer and the Coalition's members. The Postal Service will only offer packaging in areas where private business already offers this service. This provides no assistance to universal service and the private sector must compete with its own government. **The Coalition is unalterably opposed to the Postal Service providing packaging in competition with its members and requests the Subcommittee to adopt language which would prevent the Postal Service from offering this service in direct competition with Coalition members.**

There are many other problems created by this proposed service. Under H.R. 22, packaging is defined as a noncompetitive special service. However, the Postal Service

amendments propose that most special services be transferred to the competitive basket in which the Postal Service has complete pricing flexibility so long as the total competitive basket meets the revenue requirements of the bill. This is very dangerous. To the Postal Service, packaging is a device to increase its market share of its underlying services of Express Mail, Priority Mail, or parcel post. It may not even matter to the Postal Service if packaging makes a profit. The Postal Service can do a tremendous amount of competitive damage to small private businesses if it chooses to price a packaging service as at no profit to increase its stake in the underlying delivery service or Express Mail, Priority Mail, or Parcel Post.

The critical factor in the rate proceeding was the PRC requiring full system-wide cost coverage be provided to the proposed rate for packaging by the Postal Service. That cost coverage rate was 57%. If packaging is a competitive service under H.R. 22, the Postal Service could lower its PRC-recommended rate by that 57% cost coverage and reduce its overall solely to attributable costs. **This would be devastating to the small private competitor down the street.**

Mr. Chairman, our store owners are small businesses who do not have the time and resources to continually participate in future rate proceedings. The best way to deal with this matter is to adopt an amendment which will exclude packaging as a product which the Postal Service can offer. It will do the Postal Service no financial harm. The proposed recommended decision has been pending at the Postal Service for 11 months. The Board of Governors has not acted on it. Clearly, packaging is not a major issue for the Postal Service.

This is a major issue for us. Packaging is one of the most significant products our businesses sell. While we expect to compete with any private company which chooses to enter into that business, we do not believe it is fair for the federal government through the

Postal Service or the PLC to provide this competition. A proposed amendment to implement this suggestion will be provided to the Subcommittee prior to mark up.

The Postal Regulatory Commission

The Coalition has only been involved in one complaint and two rate cases at the PRC. However, our experience in these cases show how critical the Commission is. The Coalition applauds the provisions of H.R. 22 which will upgrade the status of the PRC. However, the provisions do not go far enough. During the cases in which CAUUC has participated, the Postal Service has regularly refused to disclose information important to the proceeding. Even more distressing is that the Postal Service has the final say on its own rates. As a regulated institution, this simply does not make sense. The Postal Rate Commission should be a true regulatory commission with full regulatory powers and final say on its decisions. The new Postal Regulatory Commission should also be given full authority over international mail. No justification for a distinction between domestic and international mail has been provided by the Postal Service.

Market Tests of Experimental Products

As long as packaging is a postal product which the Postal Service can offer, CAUUC vigorously opposes Subchapter V, the market test provisions of H.R. 22. Even though market tests for noncompetitive products are limited to \$10 million per year, this is a very large test for small businesses. For example, even a limited test on packaging could easily reach a large number of stores for "only" \$10 million. The proposed packaging test before the Postal Rate

Commission involved a total revenue of \$35 million and 3,500 stores in the first year and \$70 million and 7,000 stores in the second year. Even with a \$10 million limit, the Postal Service could design a very destructive "experiment" with competition in a thousand or more locations. This would be devastating to small businesses like those in the Coalition. If packaging were assigned to the competitive sector, the entire proposed packaging test could be accomplished with no PRC oversight.

The Coalition does not support any market tests for a postal product such as packaging. The existing postal laws which require a rate case for such an experiment or market test is the best way to protect small business from the threats of a "small market test."

The Postal Service Amendments

Many of the Postal Service amendments are not specifically relevant to the issues important to the Coalition. This testimony has attempted to highlight those which are relevant. Generally, the Coalition believes that these amendments give far too much flexibility to the Postal Service in its competition with private business. That is why it is critical that the changes proposed by the Coalition be adopted. So long as the thrust of H.R. 22 is to grant the Postal Service "flexibility," it is critical that small business be protected from this "flexibility." The general thrust of the Postal Service amendments are to transfer virtually all postal products with the exception of monopoly mail to the competitive basket and to require no contribution to overhead or cost coverage. This leaves the monopoly mail ratepayer to pay for the institutional costs of the Postal Service. This is a profound change from current law.

The Postal Service amendment regarding the PLC give it even more "flexibility" by

making stock and bonuses even more of an incentive for management to engage in competition with the private sector. For example, the sale of stock to the general public by the PLC is a major policy issue. What purpose does this serve? Why does the Postal Service need to own a publicly traded subsidiary? What are the pressures on universal service created by this concept? What would be the focus of Postal Service management if it can receive stock options and bonuses from the PLC? Would that focus be universal service or the stock price of the PLC?

Miscellaneous Issues

There are two other issues which the Coalition would like to raise.

1. **Packaging Rate Case** - The status of the current pending packaging rate case is unclear. Section 3721 terminates all pending rate cases. Does this mean that if the Postal Service does not act on the case that it will terminate? This is fine if H.R. 22 has determined the clear status of packaging and has eliminated it as a postal product. If not, a clear transition must be established. One could also ask what this does to R97-1, the current major rate case now on appeal before the Court of Appeals. A transition for this case may also be appropriate.

2. **CMRA Change of Address** - The Coalition expresses its thanks to Chairman McHugh and the Subcommittee for the inclusion of this provision in H.R. 22. Customers of CMRAs are the only postal customers in the country currently denied the privilege of standard change-of-address and mail forwarding. This is a fairness and equity issue. All postal customers should be treated the same.

Conclusion

Thank you again for the opportunity to testify. H.R. 22 is very important to our members, and we urge action on the bill and these amendments as quickly as possible. It is our hope that this bill can be passed this year so the implementation of the postal reform can begin quickly.

Mr. MCHUGH. Thank you very much.

As I said, I have gone through all of your testimonies and found them all very compelling. The one interesting thing, out of many, that I come away with from this process is I have never been involved in anything where there were more greater number of opinions voicing so much disparity in views that were all correct. [Laughter.]

And I take issue with none of you. I truly don't. The process we have been engaged in has been one of trying to go forward where we can and build the broadest base of support where possible. We have tried to do it in the most open and the most receptive process that was possible for us and particularly the folks over here, Robert, and Heea, and Tom, and so many others who have done such a great job.

I think it is fair to say that we have dedicated to you, as individuals and the organizations you represent, dozens and dozens of hours trying to represent your versions. We are going to continue to do what we can and where we can. But where we don't it is not necessarily a lack of understanding of your views nor a lack of concern.

I would ask you, Jack Estes, and if others of you speak for the record, please identify yourselves because you are such a large number, in fairness to the stenographer.

You say there is not a pressing concern, and I understand that view. It is not falling apart. We are not in crisis. I think, frankly, that is one of our major challenges. You heard Kamerschen suggest that is the perfect time to go forward, but I don't think we can ignore certain realities. The Postal Service tells us that by the year 2000 they are going to lose what they estimate to be \$38 billion transactions to electronic transfers and mostly in remittance mail. It is going to cost them \$6 billion. That is a heck of a chunk.

You heard, and many of you represent the interests, and Ms. Fennie certainly does, the great pain and pressure that private companies are under from what they have understandably come to know as a Postal Service monopoly that competes against them in ways that they find impossible to effectively respond to, and all of this is coalition building. I just don't know how we go forward without taking up the issue of a Private Law Corp. because I truly don't think that the environment in this Congress is such that you are going to pass through both Houses and have signed a bill that is going to restrict the Postal Service.

So what you have is the choice of continuing where we are, which means that they can use their revenues to go into area, and Ms. Fennie's spoken and written testimonies attest to that very eloquently about their less-than-successful record, but no way to stop them.

So the question is if we have the choice of doing H.R. 22, as construed, and understanding that we will try to do more things with it, or doing nothing, which is better in your environment?

Mr. ESTES. Let me say, first of all, Mr. Chairman, that many of the suggestions that we have advanced, particularly to Robert, many of them have found their way into the bill, and we are grateful for that. And your process has been open and fair. I just can't say enough about that.

The question of whether or not there is an urgency to do something is one that really gnaws at us, and it is the corroboration of whether or not there is a real problem there. We hear from the Postal Service a conjecture that they will be faced with a revenue and volume loss because of certain competitive thrusts in years to come.

But they are, in a sense, an interested party, and it may not be an unbiased party, but it clearly is an interested party that is making that conjecture. And one of the things we're struggling with is how can we bring to you, as the chairman, something that you can rely on and be comfortable with that is more than conjecture? Because the bill really does, as you know, and if you are right in that we will be faced with a serious problem, it turns our system on its ear in many ways. Now, that is not necessarily bad, but we have to be, I think, satisfied, and I think that is also important with respect to the acceptance level of the mailing community. That has to be raised.

In our group, for example, in all honesty, that acceptance level for some of these reforms aren't there not because they may not be good reforms at the right time under the right circumstances.

I think Ken wanted to say something.

Mr. MCHUGH. As I said, for the record, identify both yourself and your organization.

Mr. ALLEN. I am Kenneth Allen with the National Newspaper Association, and I am pleased to be here on behalf of America's community newspapers which inform and educate about 160 million people every week.

I should also note that I am relatively new to the postal arena, and I have had quite an education in the last year.

Mr. MCHUGH. It only gets better. [Laughter.]

Mr. ALLEN. It is an exciting area, I can tell.

Community newspapers have one major partner, and that is the Postal Service. Most of our members rely on the Postal Service because there is no alternative. And the fact is that without the Postal Service and without one that provides quality of service at adequate rates, there wouldn't be a lot of the community newspapers.

We are not here today to defend the status quo. We are here today to find a solution to a viable Postal Service in the future. And I think our concern, as part of the Main Street Coalition, is that we need to find creative and innovative solutions, and H.R. 22 certainly has a lot of those in there. We are concerned, however, with the risks of implementing all of those at this time. We think you have accomplished a lot in the past 4 years, and we think there are pieces of it that should go forward.

But there are also some risks to us. And from the point of view of community newspapers, let me just tell you what we look at, briefly, and what our concerns are. We have three concerns: One, that rates need to stay fair and equitable and that the quality of service needs to remain adequate. And we have some concerns about price caps, whether worksharing will provide incentives for the cost reductions that we see now.

Second, we are concerned that our competitors don't get better rates than we do. That is why we are concerned about negotiated service agreements.

Third, we are concerned about not competing with the very organization that delivers our newspaper, and that is the Postal Service.

So when you look at all of those, we are concerned that the risks of going forward with such a comprehensive change may lead to the demise of many newspapers. And it is easy to say that if it is wrong, in 2 or 3 years we will change it, but 2 or 3 years is a lifetime for many of the smaller newspapers in the country. And waiting that long to fix something I am concerned may not be adequate. So we want to work with you toward a solution.

Mr. MCHUGH. I appreciate that, and I would never tell you don't be worried, 2 or 3 years we will fix it. I think too much of you, and all of this oath-taking may rub off on me, and I don't want to get caught in a perjurious statement.

Just for my own interests, when you say it may help your competitor, whom are you considering your competitors?

Mr. ESTES. Our competitors are direct mail advertisers, the Internet, all sorts of media that generate advertising revenue. We have seen activities by the Postal Service in the past to promote direct mail advertising, for example, at the expense of newspapers, and we are concerned about that. We don't think that the Postal Service should be in the business of promoting one form of advertising or one form of mail over another.

And with the Private Corp., we are concerned the Postal Service may get into advertising in other areas, in and of itself, and become a competitor.

Mr. MCHUGH. I understand that. I mean, you have got situations that John Sturm can speak to about Auto Day and other things that, frankly, they are now legally empowered to enter into. I don't want to sound self-important here, the process that we are involved in, but I think one of the reasons that they agreed to withdraw was because we were involved in this process.

The concern I would have, if I were in some of your shoes and seats, is what happens if we don't do something, what comes after? My view is that you are going to see, by necessity in their view, a far more aggressive Postal Service in the kinds of areas that you are concerned about. And, again, if your belief is that the Duncan-Hunter bill that you referenced on the Core Business Act, will be passed by both Houses and signed into law, then I guess your gamble is go with nothing. But I think that is a big gamble. No one asked me, but I am not sure that is what is going to happen.

But I don't want to keep the rest of you from commenting.

Mr. STOVER. Mr. Chairman, if I may add something to Jack's answer. David Stover, the Greeting Card Association.

Mr. MCHUGH. Yes, sir.

Mr. STOVER. The question of whether it is time to reform the system, in light of how far off or how near the competitive threats from electronic media are, I think also has to be looked at in terms of whether reforming the ratemaking system is the way to meet that particular threat.

A First Class letter today costs between 23.8 and 33 cents to send, depending on what rate category it is in. If the same information can be transmitted over the Internet to the satisfaction of the sender and recipient, it is difficult to see how any foreseeable rate

reduction can compete on pure price with that electronic transaction, which perhaps costs a penny or two to execute.

As a rate lawyer of many years standing, I am afraid, like a lot of people, I tend to assume that price is everything and that what is really important is how you make the price. But I think maybe we need to step back and see what the problem is that we are trying to cure before deciding that ratemaking reform is the only solution we need to consider.

Mr. MCHUGH. Sir?

Mr. CASSIDY. Mr. Chairman, first, I think it is important to note—

Mr. MCHUGH. Pardon me. Please identify yourself and your organization. Thank you.

Mr. CASSIDY. Yes, sir. I am Lee Cassidy. I am executive director of the National Federation of Nonprofits.

Mr. MCHUGH. Thank you.

Mr. CASSIDY. I think it is important to note that you have already made an indelible mark on the Postal Service by establishing a piece of the original legislation. I guess it was H.R. 3717, that piece being the inspector general, and that was a critically important step. Now, we have talked here some about implementation. In the case of the implementation of deregulation of other utilities, and the Postal Service must be considered basically a utility, we have had supervision of that implementation by an existing Regulatory Commission, usually within the States, in some cases nationally.

I would like to suggest, sir, that the next critical step is the strengthening of the Postal Rate Commission to create the Postal Regulatory Commission, as you have proposed in H.R. 22, to give that Commission significantly greater power in order to supervise the implementation of many of the—and maybe most, and perhaps all—of the reforms that are included in the rest of the bill.

Had the Commission had those additional powers, the problems that we talked about in our testimony of the Postal Service not accurately estimating its costs, not accurately proposing rates; those problems, we believe, would have been largely corrected by a stronger Postal Rate Commission. And so from our standpoint, we see that as the next critical step and one that would permit a much smoother implementation of all of the other reforms.

Mr. MCHUGH. Well, obviously, I agree that is an important step or it wouldn't be in the bill. I don't want to leave anybody with the impression that, in our interest of making progress, being creative, and building a coalition, that we have done anything that would be unacceptable in and of itself.

The problem with your suggestion, I would suggest, or the difficulty of it, is that many people who find other parts of the bill less attractive find that one very attractive, and if you portioned that out, then they all of a sudden become far less interested in the other parts, and you start to pull the puzzle apart.

The fact of the matter is we were very fortunate, with a lot of help from Senator Ted Stevens, and a number of others on the IG, to do something that was—correct a situation that was totally unique in the Federal Government; that is, an organization the size

of USPS did not have its own inspector general. I think it was a once in a one of those lifetime moments.

And the Postal Service, and its workers and other segments honestly believe, and strongly believe, on the opposite side of where you are, that the PRC is far too powerful now, that they have never obfuscated data, and that the only thing at risk here is proprietary information that would be used to further diminish their standing by those who wish them to do not so well, et cetera. The problem being I don't think we could pass it by itself.

So that is the challenge in virtually all of these, that this is a stew or it is a bad plate of green meat in the corner. I mean, together we can make a nice stew, the parts separately, you know, your mother wouldn't serve it to you. So that is the frustrating part from here.

And when I say, again, I don't disagree with anything any of you are saying, that is the challenge.

Mr. WENDLER. Mr. Chairman, my name is Guy Wendler. I am president of Stamats Communications in Cedar Rapids, IA. We publish four business magazines and are a member of the American Business Press. The American Business Press has about 100 member companies, and we publish a 1,000 magazines. Typical circulation would be 50,000/60,000. An example of that would be our Buildings Magazine that might be read by somebody who is responsible for managing this building right here. Some of the editorial that we have in Buildings would be on indoor air quality, security, safety, things like that.

We very much appreciate the initiative that you are taking in trying to keep the Postal Service competitive and viable in the future because we depend 100 percent on it. I have no other choices to mail my magazines and none of the other members have any choices to mail the magazines as well. So we applaud your efforts in that regard, and we see some good things in the bill, such as strengthening the Postal Rate Commission.

In the spirit of perhaps providing you some of our insights on why we are concerned with the current bill, the last two rate-making proceedings that went on in the periodicals class, basically, involved an issue between the small circulation magazines and the large circulation magazines. We looked to the Postal Rate Commission to protect our interests there and I think protect public policy interests of unzoned, flat editorial rates.

We are concerned that if we move to the indexed sort of system, we will lose some of that protection, and the Post Office will be able to accomplish some of the things that they haven't been able to in the last two rate cases, which really aren't being driven necessarily by competition.

We are also concerned in that it is unclear as to how the indexing will occur, whether it will be by basket, by class, by subclass, and that could have a major impact on the smaller circulation publications, and I wanted to share that with you. I thank you for all your efforts that you are making with this, and we hope you do make progress on it.

Mr. MCHUGH. I appreciate that, and I appreciate both your comments and the supportive nature of them and the process that you have been a part of and your organization has been a part of.

If I, honestly, could see how to more effectively guard against the thing you just stated you were concerned about, I would do it. I think you heard the prior panel where, if anything, a large class of mailers, who are highly dependent on the Postal Service as well, feel that the index, coupled with very tight banding that was suggested by some of you, by the way—we didn't dream it up—is too inflexible.

If you make the assumption that your baseline rate case is fair and the PRC at that time presumably would have the increased powers that you support, so it would have a far better opportunity to produce a fair outcome in the baseline case than it presently does, then from that point forward, you are much more insulated against any—I mean, it becomes a matter of mathematics, not a matter of the whims of the Postal Service.

So my point would be, if there are ways in which you want to talk about becoming even more strict with the index and the band, we will be happy to talk about that. But you have heard the problems that raises with other people who are very dependent upon the Postal Service, as well. You heard who they represented. So my point being, I don't discount the concerns you have. I truly don't. What I am searching for is a way in which we can meet those concerns, so they are not totally disruptive to the other effort. But let me move on to another point, if I may.

I think there may be an exception or two, but most, if not all of you, expressed concerns about discriminatory pricing on negotiated service agreements. Here, too, is an area that I am very concerned about. It is a troubling aspect for you, so, therefore, it is for me as well.

You heard Mr. Kamerschen, who came here today to try to propose a way by which he felt it was a win-win situation to take a different tack on NSA's because he felt the language that we have in here is so tight that it is going to preclude any real benefit. I would ask if any of you have suggestions as to the approach we have taken on NSA's, as to what more we can do to prevent discriminatory pricing because, frankly, with the components of the current NSA that we have in there, I think we have pretty well covered that, but I want to learn.

Mr. ALLEN. I am not going to say that there aren't some changes that could be made to tighten them up. Our concern comes back to the issue that, as we see the negotiated service agreements, they will primarily benefit the large-volume users.

Mr. MCHUGH. But let me interrupt you because the requirement of the bill suggests that all similarly situated mailers have to be eligible for the same NSA, and beyond that, all discounts that derive from that singular NSA must be driven to those who don't get the discounts, as well. So it is a requirement that any benefit from the NSA be equitably distributed across the entire universe.

Mr. ALLEN. But it is my understanding that you have to, once the NSA is negotiated, that you have to file for the similar discount; is that not correct?

Mr. MCHUGH. On the NSA itself?

Mr. ALLEN. Yeah.

Mr. MCHUGH. If I understand your question correctly, it has to go with PRC prior approval.

Mr. ALLEN. And then the individual users will get the benefits without any further proceeding?

Mr. MCHUGH. If it is approved by the PRC.

Mr. STOVER. May I—

Mr. MCHUGH. What I am saying is, if there is, and we assume the PRC will approve NSA's that are of benefit, if there is a savings and a benefit of the discount to the individual NSA, that discount benefit has to be driven back to all mailers.

I don't know how else we would do that. It is not like there will be a single beneficiary. The entire mail universe will benefit.

Mr. STOVER. David Stover, again, GCA.

You, Mr. Chairman, mentioned the proposal made by Mr. Kamerschen in his testimony earlier. I did have a reaction to that. As I understand it, it would loosen the language in H.R. 22 so that the NSA mail would not have to pay the same contribution per piece as all other mail of that category. But the contract volume would have to pay the same total dollar amount into the institutional cost pool. This means that as the contract volume grew, which Mr. Kamerschen expected that it would, the per piece contribution, of course, would go down.

There was a long discussion, as I recall, in the reclassification case at the PRC about 4 years ago, in which the question, what is a fair standard for contribution, was discussed; and there the conclusion was that you could look at that per piece contribution, and if that was equal, you had fair rates.

So I don't think that you need to slacken your own language in order to achieve fairness in that regard.

Mr. MCHUGH. In fairness to Mr. Kamerschen, I don't want to sit here and critique his bill in a negative sense without going back and giving it the fair consideration it deserves, but I don't know that I disagree with what you have just said. But that is not in the bill. I am concerned, and I don't believe you were addressing that when you all submitted your testimony on H.R. 22 with respect to NSA's.

Mr. Cassidy.

Mr. CASSIDY. Mr. Chairman, I concur with Mr. Stover's comments about NSA's. But apart from NSA's, if I understood your question correctly, it is, "does the basic pricing system contribute to the elimination of or does it eliminate discriminatory pricing?" And there are some special provisions in there relating to nonprofit mailers, and I can say that, from our standpoint, it is a vast improvement over what we have now. And while I am sure if we studied it for another 4 years we could come up with some minor refinements, we find that it is something that we certainly can live with, and we would be reasonably happy with.

Mr. MCHUGH. Well, I am glad I asked.

Mr. WENDLER. I do have a comment—

Mr. MCHUGH. I said I am glad I asked. I am sorry, Lee. I didn't know if you were—go ahead.

Mr. WENDLER. On the NSA's and predatory pricing, one of the things to consider is relative bargaining power. My card is not in the Rolodex of the postmaster general. So if I wanted to call and try and negotiate something, I probably couldn't do that. And in terms of being protected by somebody else negotiating something

like that and it being available to my company, it may not because we don't have the mailing density to a particular area, so we may not be able to take advantage of any of those things.

Mr. MCHUGH. I couldn't agree more with the fact that not every mailer will be able to directly participate in NSA's. Clearly, that isn't going to happen, and there is no way you can legis—I mean, I guess we could legislate and the Postmaster General shall provide a business card to all mailers, but I don't think there's any way we can address that.

But the point about discriminatory pricing I think is that, if you were able, or any two mailers were able to participate, on the one hand, you cannot negotiate an NSA with one and exclude the other, or if it's 10 or 20 or 100, however many wish to. I would suggest that this may, in fact, open up avenues for negotiated service agreements that small business people—and, believe me, I mean that as a compliment, not an insult—but small business people probably don't have the opportunity to go out and negotiate, and develop and think about, and it could be done for them by others. Then they'd look at the menu of approved NSA's and say, gee, I might be able to benefit from that.

But even if you don't, under the unit contribution to institutional costs, you still benefit because it goes back as a unit-cost contribution that benefits every mailer. That is what we are looking at—protections, the bottom line, ladies and gentlemen. When you say you are concerned about discriminatory pricing, I am as well. We have tried to address that in a very direct manner, and Mr. Cassidy's points are well taken to the extent that we could sit here and theorize on things for the next 4 years, and ultimately we would come up with nuances of change.

But if there are ways by which, other than saying we can't do this, I mean, that is legitimate, and if that is your choice, I accept that. But, if there are ways in which we can change NSA's to your benefit and to the point of concern of nondiscriminatory pricing, that is a vitally important issue that moves us deeply. That says a couple of things; one, it is important and, two, our lives are moved by strange things. But we want to be helpful.

John Sturm.

Mr. STURM. I just thought I would offer this comment, Mr. Chairman, because you just sort of said it. I am John Sturm from the Newspaper Association of America.

I guess Mr. Kelly said it a couple of panels ago, when he was talking about the division that this bill makes between competitive and noncompetitive services. One wonders whether if you, as Congress would do in this bill, made that choice and, indeed, you had price competition in competitive services. Why, in fact, do we need to go away from the current system in noncompetitive services? In other words, it strikes me that a lot of this is great concern about areas in which, for reasons that were detailed in the earlier panel by Mr. Kelly and Mr. Smith, there is a highly competitive business in parcel delivery, and I think they did a very good job of tracing the history of that.

I look, then, at noncompetitive. You made a choice. You have put mail in different packages, and why we need to go down the route, if you will, of negotiated service agreements in noncompetitive mail

when, in fact, at least to a lot of us, it poses the risk, at least, of being in a situation where either we don't qualify or we are going to be asked to pay for the discounts that are given to somebody else. And that's, I think, the great concern here.

Mr. MCHUGH. You had me until the end. Well, you can make the argument, and I would be the first to admit the newspapers are in a very unique situation competitively in that, when you make the statement, we may pay for the discounts, you could make the argument, I suppose, that lost revenues because of lost advertising mail would be a way you would pay. But I would take exception if you meant by that, however, that you would pay for the discounts as a mailer because, as I said, we have the unit contribution requirement that, in fact, would be driven back to benefit you.

And, John, you and I have had long conversations and, as I understand it, we are going to have another one—

Mr. STURM. Probably more.

Mr. MCHUGH. I understand the unique situation that you have with the Postal Service and the question of advertising mail. But in what we call the noncompetitive areas, there are many, many mailers who, I think, would want to be classified that way, historically have been, and probably the rationale should be, who have no other real choice, who could, in fact, benefit from NSAs and could benefit, I would argue, under the way in which we have structured it to the inurement of the entire postal system. But we did, we made choices, no question about it.

Mr. STURM. My only suggestion would be, perhaps you had it right the first time when you didn't include NSAs in the bill.

Mr. MCHUGH. Perhaps we did. I don't question your right to question us.

Well, if nothing else today, we have proven, as Will Rogers said, "If two people agree all of the time on everything, one of them is unnecessary." So I guess we are all pretty necessary. [Laughter.]

So, unless one of you would like to make an additional comment, we will look at your suggestions.

I want to repeat, again, particularly on NSAs and the issue of discriminatory pricing and other such key issues, we want to try to do the best job we can. So we are looking forward to working with you.

Let me just close by saying Jack made some comments about a new process, perhaps he didn't say it in so many words, but I certainly got the indication he felt we ought to have some more hearings. We have talked about this Competitive Products Fund since it was first discussed in an opening hearing we held back in I believe it was September 1997, and then it was first proposed a year ago—Private Law Corp. is what I am supposed to be mentioning—a year ago in December, and we have had several hearings, including this one.

And I, in no way, diminish the concerns that you have, but I think, when you couple the relative age of the proposal and the numbers of hearings we have had, and the repeated opportunities that we have provided and, thankfully, you have accepted to talk about this issue, that we really have, after 4-plus years now, reached a time when we have got to start making some decisions about that.

So, as my opening statement said, I still believe, and I am always willing to learn, but I still believe we may have come to the public hearing end of the road, but we are only at step one on the legislative side, and we have not yet drafted a final bill. I think it is fair to say that when we first introduced H.R. 22 as a new proposal a little more than a year ago, a lot of individuals were fairly surprised at the depth of changes we made.

If nothing else, I hope you will admit it shows that we are listening to a lot of people, and we are going to continue to do that. I am not making any predictions, but I am suggesting to you that we are going to try to be as open and as receptive as we can.

Jack, are you just showing me your pen or did you want to say something?

Mr. ESTES. I was just showing you my pencil.

Mr. MCHUGH. It is a nice pen. [Laughter.]

Mr. ESTES. I would like to say that these have not been 4 wasted years. I mean, really, we have made progress, and a lot has been done, a lot has been accomplished. As I said earlier, we, unfortunately, are uncomfortable about some of the major thrusts of the bill.

Mr. MCHUGH. I understand that, and I hope I never suggested that I do disrespect that because I don't. And I don't feel they have been wasted. It has been a fascinating opportunity for me. I have worked with some terrific people.

We will go to markup, and there is a time to say it, but the times I have looked bad are my own fault. The times I may have looked good, it is because of these people here. A tremendous staff. I have never been so fortunate in nearly 30 years in public office and public life to work with more caring, more thoughtful and hardworking folks. So I want to thank them for a great job, and you know them all. Robert, and Tom, and Steve is here. So many who go back ever since Bill Clinger made that ill-fated call back in 1993. That will teach you to answer the phone, folks. [Laughter.]

Thank you very much. We will be in touch.

[Additional questions for the record follow:]



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John F. Starns
President and CEO

March 31, 1999

The Honorable John M. McHugh
Chairman, Subcommittee on the Postal Service
Committee on Government Reform
B-349C Rayburn House Office Building
Washington, DC 20515

Dear Chairman McHugh:

Thank you once again for allowing me to appear before your subcommittee on behalf of the Newspaper Association of America and the Main Street Coalition for Postal Fairness.

Attached are my responses to the questions posed by the subcommittee's ranking minority member, Congressman Chaka Fattah. If I or one of my staff can be of any further assistance, please do not hesitate to call. Thank you for reading.

Sincerely,

A handwritten signature in black ink, appearing to read 'John', with a large loop at the end.

Newspaper Association of America*
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703-902-1601 FAX 703-902-1609
e-mail: starn@naa.org
PRINTED ON RECYCLED PAPER

March 31, 1999

Follow-up questions directed to John Sturm, Newspaper Association of America

Question One. *As currently written, H.R. 22 would have rates for all products set in a baseline case and, subsequently, the maximum rate for each product would be determined by applying a uniform percentage adjustment to the prior year's maximum rate. Over time, the cost relationships of the different mail products are likely to change.*

Do you believe that the bill should include some periodic re-calibration of rates to realign costs and rates and prevent excessive shifting of overhead burdens among products?

Answer. NAA does not favor the price cap structure contained in H.R. 22. Nevertheless, if H.R. 22 continues to have a price cap structure as a means of establishing postal rates, a periodic re-calibration rate case would be essential. That procedure would help to ensure that postal rates reflect actual costs and that overhead costs are fairly apportioned.

Question Two. *You propose on page five of your testimony that the PRC should have authority to review whether the Postal Service should expand into a particular new type of service. Why do you think there needs to be prior review before the postal service expands into a new field?*

Answer. The decisions relating to new services to be offered by the Postal Service, the appropriate breadth of those services, the prices to be charged for those services, and the competitive impact of those services are *public policy* questions that should be decided by the Postal Rate Commission and not the Postal Service unilaterally. As we pointed out in our testimony, from our own recent experience with Auto Day, we do not believe that the Postal Service should have the authority to implement "market tests" that are designed to shift significant business from the private sector to the federal agency without prior approval of the Postal Rate Commission. Without Congressional intervention, we believe the Postal Service could have used the Auto Day pilot project to create havoc in the Milwaukee marketplace while the PRC considered the matter. Prior approval by the PRC of all market tests is necessary.

Question Three. *You suggest on page two of your testimony that the PRC should be given the authority to require the postal service to gather necessary data. Do you think current rates would be more equitable if the PRC had this authority now?*

Answer. Yes. Many times in the past, the PRC has desired data of a particular nature and requested the Postal Service to gather and produce it. In those situations, the Postal Service typically asserts its regulatory prerogative by ignoring the issue and not gathering the data. These actions improperly handicap the PRC, which is left with poor or inadequate data on which to base its rates. Those rates, therefore, are not necessarily the most equitable, because Congress has not given the PRC the tools it needs to use in considering the Postal Service's rate requests.



Greeting Card Association

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April 2, 1999

The Honorable John M. McHugh
Chairman
Subcommittee on the Postal Service
U. S. House of Representatives
2157 Rayburn House Office Building
Washington, DC 20515-6143

Dear Chairman McHugh:

Enclosed are Mr. David Stover's responses to the questions posed by Representative Fattah in regard to the hearings on H.R.22, The Postal Modernization Act of 1999.

Thank you, again, for the opportunity to express our views.

Sincerely,

Marianne McDermott
Executive Vice President

Enc.

ANSWERS TO POST-HEARING QUESTIONS

Hearing on H.R. 22
Subcommittee on the Postal Service
March 4, 1999

Some witnesses have advocated that competitive products not be required to make any contribution to institutional costs after five years. If competitive products cease to contribute to the postal service overhead, what impact will this be likely to have on the rates for noncompetitive products?

ANSWER: If competitive products did not contribute to the Postal Service's institutional costs, the rates paid by noncompetitive products would almost certainly have to be raised. The citizen mail user - who sends mostly single-piece First-Class letters and receives no presort or automation discounts - would bear the brunt of the increases.

H.R. 22 tries to insure that the Postal Service would obtain adequate revenue from postal operations. It provides that the Service may increase rates even faster than the Consumer Price Index, if -

postal revenues during the upcoming ratemaking cycle would otherwise be insufficient to enable the Postal Service, 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.

Proposed § 3733(c)(2)(B)(ii). This is, in effect, a requirement, similar to that in present law, that the USFS be able to recover all its costs (attributable and institutional) while providing adequate, appropriate postal services. This requirement that the revenue limit be raised applies, however, only to the rates for mail classes subject to the price cap - that is, to noncompetitive mail. Accordingly, when the Postal Service needs more revenue to break even, the revenue

dollars lost by not charging competitive services any contribution to institutional cost would be made up by seeking additional revenues from noncompetitive mails.

This problem would become more acute if one or more important subclasses of mail were transferred from the noncompetitive to the competitive category. If such a subclass, after being transferred, made no contribution to institutional costs, the dollars it formerly contributed would have to be made up by the (now smaller) competitive category. For example, if the entire Enhanced Carrier Route subclass of Standard A mail were moved to the competitive side, and thereafter made no institutional-cost contribution, another \$2.17 billion (R97-1 rate levels) would have to be exacted from noncompetitive ratepayers. (For comparison, under R97-1 rates First-Class letters contribute about \$14 billion.)

All forms of mail rely on the postal functions covered by institutional costs. All should be taxed for their fair share of the contribution needed to cover these costs -- as the statutory guidelines administered by the PRC now require.

As currently, written, H.R. 22 would have rates for all products set in a baseline case and, subsequently, the maximum rate for each product would be determined by applying a uniform percentage adjustment to the prior year's maximum rate. Over time, the cost relationships of the different mail products are likely to change.

Do you believe that the bill should include some periodic re-calibration of rates to realign costs and rates and prevent excessive shifting of overhead burdens among products?

ANSWER: The bill would be improved by such a re-calibration ("true-up") provision, though that change alone would not eliminate all the problems inherent in its price-cap scheme. Costs change over time.

But rates, after a few years of the proposed annual rate adjustments, are unlikely any longer to bear a close relationship to efficiently incurred costs. Therefore, substantial differences in the relationship between fairly allocated costs and the escalated rates are clearly to be expected unless a true-up is employed at regular intervals.

The question actually postulates two distinct possible roles for a true-up case. First, holding such a proceeding every few years clearly could insure that changing cost patterns have not brought the rates for some services below attributable cost (i.e., "realign costs and rates" - cf. proposed § 3732(b) of H.R. 22). This is a somewhat limited, though certainly useful, objective. Moreover, a complete true-up would allow rates to be reduced if costs declined.

Secondly, the true-up case could re-establish - at least temporarily - a desirable relationship among the relative institutional-cost burdens borne by the respective classes. This in turn raises the question of what standards the Postal Regulatory Commission would apply in establishing the relationships among different classes' institutional-cost contributions. The baseline rate case provision of H.R. 22 [proposed § 3721(b)] calls for application in that case of the present ratemaking standards (39 U.S.C. § 3622). There is no apparent reason why overall rate policy should change between baseline and true-up cases, and it therefore seems that in a true-up case the § 3622 standards should continue to apply.

STAMATS

COMMUNICATIONS, INC.

April 13, 1999

The Honorable John McHugh
United States House of Representatives
Washington, D.C. 20501

The Honorable Chakah Fattah
United States House of Representatives
Washington, D.C. 20501

Dear Representative McHugh and Representative Fattah:

Thank you for the letter from the Chairman of March 16 forwarding questions concerning my testimony on March 4th on behalf of American Business Press. I am pleased to provide my response here to the single question addressed to me as well as to offer my thoughts on the question addressed to "any witness" on our panel. I will begin with the question addressed to me:

QUESTION: Your testimony describes the Postal Service's proposal to bifurcate periodicals in its 1995 reclassification request to the PRC and how this proposal would have substantially increased rates for smaller circulation periodicals. You go on to state that the PRC rejected this proposal. Would H.R. 22 allow the Postal Service to use its flexible ratemaking authority to achieve this result?

ANSWER: Yes. By allowing the Postal Service to change rates within the Regular Rate Periodicals subclass without any justification and, of course, without Postal Rate Commission review, H.R. 22 would allow the Postal Service to obtain the same rate results for periodicals that it sought unsuccessfully in the 1995 reclassification proceeding. In that case, the Postal Service's ultimate goal was to obtain approval of a large percentage decrease in the rates for the relatively few large circulation periodicals offset by an even larger percentage increase for the thousands of smaller circulation periodicals, such as those published by ABP members and many others. Its means to that end was to split the subclass into two new subclasses, thus facilitating the rate differentiation it sought. H.R. 22 would appear to impose certain, at this point, ambiguous limits on the Postal Service's ability to deviate from the mean with respect to individual "products" or even individual rate cells. If the limits are applied only at the product or subclass level, then offsetting, "revenue neutral" rate changes exactly like those proposed and rejected in the 1995 case could be implemented right away. If all of the limits are applied at the discrete rate cell level, their application would probably not permit the massive change rejected in 1995 to be implemented all at once. There is no doubt, however, that even under this scenario, the Postal Service could over a relatively short period of time move selected rate elements (such as the zoned advertising pound rates and the various, presort level dependent piece rates) in different directions in order to produce the same rate effects that the Postal Rate Commission properly

Page Two
April 13, 1999

rejected in the 1995 case. To us, of course, it does not matter whether a rate increase needed to offset decreases for others results from reclassification or from "rate flexibility."

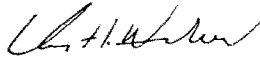
GENERAL QUESTION: As currently written, H.R. 22 would have rates for all products set in a baseline case and, subsequently, the maximum rate for each product would be determined by applying a uniform percentage adjustment to the prior year's maximum rate. Over time, the cost relationships of the different mail products are likely to change. Do you believe that the bill should include some periodic re-calibration of rates to realign costs and rates and prevent excessive shifting of overhead burdens among products?

ANSWER: My answer to this question would be a qualified "yes," qualified because the question appears to assume that costs and cost changes are the only area in need of this periodic review and re-calibration. ABP believes that the present law, which requires consideration of such issues as impact, fairness, and the need to "bind the nation together," as well as costs, has worked well. We would therefore urge that any periodic review, presumably by the Postal Rate (or Regulatory) Commission, not be limited to assuring that rates appropriately reflect costs but that the Commission's mandate be as broad as that contained in the present law. Having said this, I hasten to add that we continue to oppose a rate-setting scheme that would permit the Postal Service to inflict harm on our segment of the publishing industry even if, every five years, the Commission is permitted to investigate the appropriateness of the rates. Rates that are unfair four years out of every five cannot be tolerated.

* * *

I greatly appreciate the opportunity to provide these additional comments and hope that they are useful as you continue your search for changes to our postal system that increase the ability of the Postal Service to participate in a market that is competitive for some of its services while protecting those mailers that have no realistic delivery options.

Very truly yours,



Guy H. Wendler

cc: Members of the Postal Subcommittee

Mr. MCHUGH. The hearing is adjourned.

[Whereupon, at 4:31 p.m., the subcommittee was adjourned.]

[The prepared statements of Mr. Sturm, Mr. Cassidy, Mr. Stover, Mr. Wendler, Mr. Allen, Mr. Dzvonik, Mr. Disbrow, Ms. McFadden, and Mr. Williamson, and additional information submitted for the record follow:]

Statement
of
John F. Sturm
President and Chief Executive Officer
Newspaper Association of America

Before the
Subcommittee on the Postal Service,
Committee on Government Reform
of the
United States House of Representatives

March 4, 1999

Statement of John F. Sturm
President and Chief Executive Officer
Newspaper Association of America
March 4, 1999

Mr. Chairman, members of the subcommittee, it is a pleasure to appear before you today to discuss H.R. 22—the Postal Modernization Act of 1999. We appear before you today as a member of the Main Street Coalition for Postal Fairness, a group that represents approximately 40 percent of the mail volume in the United States. Most Main Street members are small mailers.

We welcome the opportunity to appear before you and sincerely appreciate the enormous effort that you and your staff have devoted to this process in recent years. Since NAA has commented extensively on earlier drafts of H.R. 22, and those comments still stand, my comments today will focus directly on the areas of the bill that we can support and areas that continue to present fundamental problems for the newspaper industry.

NAA is a national trade association headquartered in Vienna, Virginia, that represents more than 1,700 newspapers in the U.S. and Canada, accounting for 87 percent of the U.S. daily circulation. While most NAA newspapers are dailies, many weekly newspapers are also members.

The Postal Service is very important to newspapers. We use Periodicals and Standard mail to deliver our editorial and advertising products. We also have a strong First Class interest since we, unlike most businesses, receive the vast majority of our revenue through the mail.

Although newspapers are among the Postal Service's largest customers in any local area, the Postal Service has come to view newspapers as competitors, and has targeted newspapers' advertising revenue for diversion to direct mail advertising. The Postal Service has engaged in extensive marketing efforts to achieve this goal, even noting in its 1998 Marketing Plan that one of its objectives was to "create the platform for moving substantial revenues from pre-printed newspaper inserts into mail."¹ This certainly was not a role envisioned by Congress when it reorganized the Postal Service in 1970.

NAA believes that the Postal Service was intended to be and should remain a public service. As such, it should focus on and improve its performance of its core mission—efficient, universal mail delivery at non-discriminatory rates. Our views concerning H.R. 22 reflect this fundamental position.

NAA supports a number of provisions of H.R. 22, including those which would strengthen oversight by the Postal Rate Commission and improve its ability to ensure that the Postal Service does not stray from its public service mission. These provisions include:

- Giving the PRC subpoena power over the Postal Service so that the PRC has sufficient information to determine whether rates fully cover attributable costs and bear a fair share of overhead costs. We believe this provision should be strengthened by giving the PRC the power to require the Postal Service to gather data, and keep whatever systems of accounts, contracts, and other "business" systems the PRC finds appropriate.
- Relaxing banking requirements for the Postal Service in order to allow it to bank and to borrow capital under more favorable conditions.

¹ *United State Postal Service 1998 Marketing Plans*, October 1997 at page AD 40.

- Strengthening the Inspector General's office in order to more closely monitor the Postal Service.
- Improving contracting, transportation, law enforcement, and labor matters for the Postal Service.

As has been detailed in previous submissions to this subcommittee, NAA has fundamental concerns about the basic thrust of H.R. 22, which allows a government agency with a *de jure* monopoly to compete with the private sector. NAA believes that government entities should offer commercial services only where there is market failure—that is, where the private sector either cannot or will not offer such services. That is clearly not the case here, and NAA therefore believes that the competitive policy choices made in H.R. 22 are in error, and not consistent with the Postal Service's public service mission.

We note that even if Postal Service competition with the private sector were to be condoned, it is absolutely critical that Congress—and not a regulatory agency—choose the areas in which the Postal Service would be allowed to compete, and on what terms. Likewise, any decision to expand the areas in which the Postal Service could compete on a largely unfettered basis is an important public policy question that Congress—not a regulator—must make.

In any case, whether or not Congress decides to split postal products between competitive and noncompetitive categories, we believe certain specific tenets are crucial:

- Congress should ensure that joint and common costs are allocated in such a way that the small mailer—beholden to the monopoly—is not left paying the tab. H.R. 22 does not indicate how joint and common costs would be allocated between competitive and noncompetitive products today and in the future. According to

the figures in the last rate case, First Class (including Priority Mail) is assessed 85 percent of the overhead costs of the Postal Service even though it represents only 53 percent of the mail volume. Given the power to allocate joint and common costs, we believe the Postal Service would shift even more costs onto First Class.

- Congress should not give the Postal Service pricing flexibility. Allowing pricing flexibility within baskets for products identified by H.R. 22 as “noncompetitive” gives the Postal Service the ability to discriminate in favor of the largest mailers at the expense of small mailers. The rates within a basket should rise and fall together, so that small businesses and the citizen mailer do not fall victim to pricing discrimination.

- The “exceptions” allowing for a positive adjustment of rates for “noncompetitive” products are much too broad. While the exception for statutorily imposed funding obligations appears, at least at this point, to be reasonable, the other simply is too vague. Under proposed 39 U.S.C. §3733(c)(2)(B)(ii), the test for a positive adjustment factor would be if the Postal Service—under a “best practices standard”—would need additional revenues to continue to develop postal services of the kind and quality adapted to the needs of the United States. This provision unintentionally undercuts the discipline that the bill seeks to impose on the Postal Service, and needs to be considerably narrowed.

- The Postal Service should not offer contract rates or volume discounts. The Postal Service is a public service organization, with certain governmental advantages, that provides mail delivery services for the benefit of *all* its citizens. The Postal Service should not “price like a business” and give one customer a better “deal” than another. There is no place in our country’s postal policies for the notion that those who can bring in more “trade” should be favored over those who cannot. The principle of equal rates for equal service—no special deals allowed—should remain a bedrock of any American postal system.

- The Postal Service should not implement “market tests” that could lead to a shift of business from the private sector to the federal agency without prior approval of the Postal Rate Commission. The public policy decision of what types of new services to offer, the appropriate breadth of such services, the prices to be set, and the competitive impact is a question of the first instance for the PRC, not the Postal Service.

In a more general view, NAA has serious doubts about applying a price cap system to a governmental entity. The goal of price cap regulation is to achieve greater cost control and specific, tangible benefits for the average consumer. NAA supports these goals. But price caps are meant to maximize shareholder pressure on management, in order to maximize efficiency, and thus profits. Thus, a price cap is a regulatory mechanism whose success turns on the presence of shareholders. How a price cap system would work—or whether it could work at all—with an entity that has no shareholders is not clear. It is telling that none of the economists who testified before this subcommittee in April 1997 were able to support a price cap structure for a government entity such as the Postal Service.

In further regard to price caps, we were sharply dismayed by the Postal Service’s proposed amendments, which would eliminate the discipline that the price cap in H.R. 22 seeks to impose and eviscerate the other safeguards in H.R. 22.

Finally, NAA strongly opposes the notion of a separate private law subsidiary that could buy private sector corporations (or form joint ventures) for the purpose of selling postal and non-postal products. NAA believes that the Postal Service and its employees

would have both the incentive and opportunity to favor the subsidiary (and the companies in which it has investments) when delivering the mail and providing other services. If Congress decided to create an entity that could offer postal and nonpostal products to the public on a “private law” basis, NAA believes that the entity should be a private entity, entirely separate from the Postal Service, with no chance of Postal Service control and no chance of misallocating common costs.

In summary, the competitive policy of this country traditionally has been that government should not compete with the private sector, absent market failure. NAA believes that this is sound policy, which has stood the test of time, and finds it unfortunate that H.R. 22 does not embrace it. We appreciate that the bill contains a number of provisions that are intended to prevent Postal Service exploitation of its governmental status and to protect monopoly ratepayers from subsidizing Postal Service forays into competitive markets. These safeguards include structural separation and cost allocation provisions. NAA believes, however, that these protections would be inadequate, or, as in the case of price caps, are not yet sufficiently proven. Thus we are concerned that the net result of H.R. 22 would be to risk further disadvantaging those members of the public whom the Postal Service is intended to serve.

On the other hand, as detailed above, we are glad to support those provisions of H.R. 22 that focus on improving the Postal Service’s performance of its core mission of providing efficient, universal mail service at non-discriminatory rates. We believe that those measures represent a big step forward.

Thank you for considering our views.

**TESTIMONY OF LEE M. CASSIDY
ON BEHALF OF THE NATIONAL FEDERATION OF NONPROFITS
BEFORE THE HOUSE OF REPRESENTATIVES
SUBCOMMITTEE ON POSTAL SERVICE**

MARCH 4, 1999

Mr. Chairman and Members of the Subcommittee, we appreciate this opportunity to comment on H.R. 22, the Postal Modernization Act.

The National Federation of Nonprofits is a 17 year old coalition of more than 300 charities, religious groups, colleges, universities, and their alumni associations, museums, and other nonprofits, all of which use direct mail to raise funds and otherwise communicate with members and contributors. I serve as executive director.

A strong and efficient Postal Service is critical to the continued existence many of our members, and affordable nonprofit postage rates are an essential element in the achievement of their missions.

We applaud the Chairman and his staff for their efforts in taking on the massive task of developing comprehensive legislation to modernize the Postal Service. We are impressed with the amount and depth of detail they have considered, absorbed, and translated into this legislation. And we appreciate the unfailing graciousness of the staff in handling inquiries, requests, statements, and even our occasional complaints.

The National Federation of Nonprofits is a member of the Mailers Council and the Main Street Coalition for Postal Fairness. Moreover, we meet and speak frequently with representatives of numerous other "umbrella" organizations, and while we do not agree with every position taken by all those organizations regarding H.R. 22, we are generally on the same side when it comes to the major issues addressed in the legislation.

For that reason, we will not comment on most issues, important as they are, but will defer to others to make the points on our behalf, and will concentrate on those few issues of critical importance to nonprofits, and especially to our members.

The organization I head has been highly critical of the Postal Service's performance in several areas, especially in the last rate case. It is our belief that the Service urgently needs both legislative and regulatory oversight and assistance, if it is to operate effectively and improve efficiency.

To that end, we are concerned that, by being so comprehensive, the Postal Modernization Act may represent more modernization than some groups of mailers may be able to digest. There are elements in the legislation about which we feel strongly positive, and hope that those parts will become law soon, even if others must be put aside until the awareness of the postal community catches up with the Chairman's vision.

Having said that, let me concentrate on those provisions in which we are most interested.

At the request of nonprofits, HR 22 contains language which would create a 'requestor' rate for nonprofit periodicals, correcting a legislative drafting error of some years ago. We are grateful to you for including that language, which would bring to nonprofits long-overdue parity on this issue.

The National Federation of Nonprofits strongly supports the provisions recasting the Postal Rate Commission as the Postal Regulatory Commission, and giving it additional powers, including investigating and resolving complaints, and subpoena power. But we also would like to see the staff of the Commission given a new responsibility and power: to review, upon request of the mailers, decisions affecting eligibility for various classes of rates, for both regular rate and nonprofit mail.

Nonprofits now are engaged in literally hundreds of disputes with the Postal Service over the eligibility of various mailpieces. In most of these cases, the decision of a local postal official to deny nonprofit rates is based on either a misreading of the Domestic Mail Manual (DMM) , or a highly creative interpretation of the DMM or relevant law.

One recent case involved a refusal by a postmaster to accept a mailpiece at nonprofit rates because it was designed and printed by a commercial organization, which was a supplier to the nonprofit. The postmaster claimed that the involvement of the commercial organization made the mailpiece a cooperative mailing, and therefore ineligible for nonprofit rates. That nonsensical situation can be multiplied by many hundreds, to understand the problems nonprofit mailers face every day.

Our proposal would make the staff of the Postal Regulatory Commission the final arbiter, rather than the Postal Service itself, which has the understandable bureaucratic imperative to not overturn decisions, even wrong decisions, made at lower levels, because of the desire to maximize revenue....even, apparently, at the expense of fidelity to the law and regulations.

We support the provision of H.R. 22 to put nonprofit and commercial mail in pricing baskets based on the mail class, and oppose the Postal Service's proposal to place all nonprofit mail in the same basket. While the Postal Service has claimed that its purpose is solely to protect nonprofits, we are concerned because history has told us that separate is almost never equal. We can well imagine a situation, were the Postal Service's proposal to be enacted, where the Postal Service would be authorized, under the price cap scheme, to increase rates by a given percentage, and elects not to increase commercial rates, but does increase nonprofit rates.

The annual percentage increases might be small, but even a modest two percent per year, over the five year period of indexed rate increases between Postal Regulatory Commission review as proposed in H.R.22, could amount to an additional 10 percent differential vis a vis commercial rates. We believe the protections afforded nonprofits which the Chairman has included in the legislation are far superior to the Postal Service's proposal, and have the further desirable effect of making the interests of commercial mailers and nonprofits similar in each annual rate increase.

One of the purposes of HR 22 is to create a situation where mailers have predictable rates and affordable increases. But the history of nonprofit rates since passage of the 1970 Postal Reform Act has been just the opposite. In fact, since the Postal Service was created in 1971, nonprofits have experienced 23 rate increases, in addition to increases coming out of omnibus rate cases, plus several new restrictions on what can be included in nonprofit Standard A mail.

One of the results of those increases is that for several years nonprofits have paid the same postage rates for the advertising portion of Periodicals mail as do commercial publishers. There is no nonprofit rate for the advertising portion of nonprofit Periodicals mail.

Mr. Chairman, those 23 increases in nonprofit rates mentioned above have all been ordered by Congress. The first 16 annual increases, from 1971 through 1987, were intended to bring nonprofit rates up to an appropriate relationship with commercial rates. Six of the annual increases were to fill the gap created by the elimination of funding for Revenue Forgone; nonprofits were involved in developing that legislation, and agreed to the increases. But one rather large increase was a result of action to reduce (but not eliminate) funding for Revenue Forgone, in order to free funds for other, non-postal programs. Twice, Congress enacted significant new restrictions on the content of nonprofit Standard A mail.

Again, all these increases were ordered by Congress.

We mention this not to complain, but to point out that, while one of the objectives of the 1970 Postal Reform Act was to get Congress out of the business of setting postal rates, in fact Congress never actually has gotten out of that business, as far as nonprofits are concerned.

Twenty three times since 1971 nonprofits have seen rates increase, by Acts of Congress. To be fair, we also had a rate rollback, in 1982, also as a result of Congressional action, when it became apparent that the Postal Service was not playing by the rules. Now, 17 years later, it's time for Congress to order another rate rollback, and as noted above, there's plenty of precedent for that action

As you know, Mr. Chairman, in the last postal rate case, nonprofit rates for Standard A mail increased, on average, by FIVE TIMES the percentage increase experienced by commercial mailers. Commercial rates were increased by the smallest amount ever, and we congratulate commercial mailers, the Postal Rate Commission, and the Postal Service for getting it right. But, unfortunately, the Postal Service has a long history of getting it wrong.

Here are some examples:

In the 1994 rate case, which was trumpeted as an "across the board" increase of 10.3 percent, the Postal Service initially determined that the costs for processing In-County newspapers had increased dramatically over the previous three years, and proposed increasing the rates by more than 30 percent. It turned out that what the Postal Service counted as an In-County publication more often than not was something else, and the final result was a rate decrease for In-County newspapers of about 2 percent.

In the Classification Reform case in 1996, the Postal Service admitted that it could not get a proper fix on the costs of Classroom mail, and proposed that, for administrative convenience, Classroom rates be made the same as nonprofit rates. By eliminating the rate, there would be no further need to (incorrectly) measure the costs of Classroom mail.

In the last rate case, R97-1, the Postal Service demonstrated again that it could not accurately measure the cost of mail, in this case nonprofit Standard A mail, and the Commission in its recommended decision acknowledged that fact. So the rate for basic nonprofit Standard A mail, used by the smallest mailers, increased by 22 percent, while the same mail sent by commercial mailers actually decreased by 8 percent, a situation that makes so little sense as to be farcical. Moreover, the average increase for nonprofits, as noted above, is FIVE TIMES the percentage assigned to commercial mailers.

The Postal Rate Commission thought so little of the Postal Service's numbers in the last rate case that it reduced the total revenue requirement by a third, and adjusted most individual rates

downward. Proposed nonprofit rates were reduced by about 15 percent, with the Commission saying that, unfortunately, the record didn't permit a larger decrease. But we believe the Postal Service's record in this and previous rate cases speaks for itself.

Congress also had difficulty with the last rate case. As you are well aware, by a vote of 393 to 12, the House resolved that there should be NO increase as a result of the last rate case.

Mr. Chairman, you, too, obviously have been troubled by the Postal Service's inability to generate costing data that is accurate and precise, as evidenced by your order to the General Accounting Office to work with the Postal Rate Commission and the Postal Service to learn how the data can be improved.

Apparently, not even the Postmaster General trusts his own agency's figures. In one of his first major appearances, before the National Postal Forum last September, Mr. Henderson said that the Postal Service needed to build an "information platform" of real-time data, so it could know what its costs are, instead of relying, as it does in rate cases, on sampling. In fact, the Postmaster General said, "You can't rely on a sampling system to know where your costs are growing". But that is exactly what the Postal Service has done, to the detriment of nonprofit mailers, Classroom mailers, In-County mailers, and others.

Mr. Chairman, I'm sorry to say that we've been saving the worst for last. In yet another horror story, we recently learned that nonprofit rates were increased so much in the last rate case that some are actually higher than commercial rates, in clear violation of Congressional intent, and possibly in violation of the law. One of our members, the Elks Magazine, recently reported that the February issue of the Magazine....the first issue mailed under the new rates which took effect January 10th....cost about \$1800 more to mail at nonprofit rates for Periodicals than if it had been mailed at commercial rates. This was an apples-to-apples comparison, and is demonstrated proof that the Postal Service cannot propose accurate and appropriate rates.

We have appended to this testimony a letter from the circulation director of the Elks Magazine, along with two sheets showing the rate calculations, demonstrating the facts just discussed.

Moreover, we learned even more recently that yet another member of the National Federation of Nonprofits, an organization that wishes to remain anonymous, experienced the same problem at the same time: it paid more for nonprofit postage rates than it would have paid in commercial rates, to mail its magazine. Also appended is a letter from the printer/mailer, along with calculations showing the differential.

Mr. Chairman, it is one thing for the Postal Service to claim, as it has in letters to you and other Members of Congress, that sometimes nonprofit rates have increased by smaller amounts than commercial mail. But the Postal Service has selectively cited certain rate increases, while ignoring the current huge differential. And here we have demonstrated proof that, in clear violation of Congressional intent, some nonprofit rates are actually higher than the equivalent commercial rates.

We believe that action should be taken immediately to correct this and other horrors of the R 97-1 rate case. We believe this action should be taken in advance of and independent of H.R.22.

We know how reluctant Congress is to take such action. We know that you and your colleagues would much prefer that the Postal Service and Postal Rate Commission work together to correct this problem. But, absent a full-blown rate case, they cannot. The law does not permit such a discrete action. And even a full-blown rate case puts nonprofits at a disadvantage, with small organizations on one side and the \$60 Billion Postal Service, with its cadre of attorneys, rate analysts, consultants, economists, and the like on the other side. Most of those people are on staff, so the marginal cost to the Postal Service for a rate case is modest, while the cost to organizations of ratepayers who intervene, and especially for nonprofits, is enormous.

Like all other mailers, nonprofits need small increases and predictable rates. Unlike other mailers, nonprofits cannot increase prices when costs increase. A charity cannot say to its contributors, "You must send more money because our postage rates have increased". And fraternal organizations such as the Elks cannot say to its membership, "The Postal Service only made \$5-plus Billion profit in the last few years, so we have to increase your dues."

Nonprofit rates, in recent years, have not been predictable and nonprofits have not seen small increases. Rates have gone up frequently...at least once a year (and sometimes twice), almost every year for the last 28 years...and often, as in the last rate case, by large amounts.

Mr. Chairman, your legislation recognizes the special problems of nonprofits. Further recognition of the problems...especially the increase in rates of FIVE TIMES the increase assigned to commercial mailers... is dramatically expressed in the thousands of letters nonprofits have sent to you and your colleagues in Congress over the last several weeks. This new information presented by the Elks Magazine and the second magazine is still further demonstration that the problems are widespread, egregious, and urgently need to be solved.

Congress has shown a willingness to act to increase nonprofit rates 23 times, and to tighten eligibility several times as well. Now it's time to take action to reduce nonprofit rates. Each day that rates are improperly high is a day when nonprofits are sending their precious dollars to the Postal Service, instead of using that money in pursuit of their missions.

Please, Mr. Chairman, enact legislation in advance of H.R. 22, to roll nonprofit rates back to the same percentage increase assigned to commercial mailers for equivalent mail. That legislative approach is consistent with the optional pricing method for nonprofit rates which you have included in H.R. 22. It is something that you and your staff have already considered and agreed to as an acceptable means to determine nonprofit rates.

The cost to the Postal Service of such action would be about \$75 Million, depending upon how the figures are computed. Postmaster General Henderson recently said that a business that size is too small for the Postal Service to enter. He said there's "no money" in businesses that size...or no money worth the USPS getting involved with. He might just as well have referred to the amount as "pocket change" to the \$60 Billion Postal Service. In fact, \$75 Million is about one-eighth of one percent of the Postal Service's annual revenue. Stated another way, it's less than the agency's forecasting error each quarter. But for nonprofits, the amount is enormous, and it represents \$75 Million in unwarranted nonprofit rates, this year, and every year in the future.

Mr. Chairman, we appreciate the opportunity to testify today on behalf of our hundreds of members, all of whom are hurting because of unjustifiably large rate increases on January 10th.

The problem is large, and the solution is urgently needed.

Congress can correct the situation.

Only Congress can correct the situation.

We hope you will lead the charge.

Thank you.

The Elks Magazine

425 West Diversey Parkway
Chicago, IL 60614-6196

February 19, 1999

Mr. Lee M. Cassidy
Executive Director
National Federation of Nonprofits
815 Fifteenth Street, NW, Ste. 822
Washington, DC 20005-2201

Dear Mr. Cassidy:

The February 1999 issue of *The Elks Magazine*, mailed Periodical-Nonprofit, would have cost \$1,800 less had we mailed it at Periodical-Regular rates. The attached analysis supports this over-charge from the United States Postal Service. *The Elks Magazine* said goodbye to preferred rates January 10th and hello to higher prices —higher than commercial publishers pay.

Our postage was roughly \$163,000 for a distribution of 1.185 million. USPS Milwaukee Business Mail Entry confirmed Periodicals Regular postage would have been \$161,000.

The Elks Magazine co-mails and drop ships from Quad/Graphics-Hartford, WI 53027. Our magazine is automation compatible and has a relatively dense distribution. Our February advertising percentage was almost 31% with an issue weight of 3.4 ounces.

The Elks Magazine postage would have equaled commercial postage at 39.5% advertising, all else constant. Above 39.5% it would be less. The *non-advertising percentage discount* is key in determining the better overall mailing cost. This is particularly true for a nonprofit magazine with low to moderate advertising. Nonprofit and regular periodicals pay the same pound rates for advertising. At the piece rate, nonprofit is lower than regular. So, you could say nonprofit rates are lower, but this is only true when a high amount of advertising is published —and not true for *The Elks Magazine*.

This example is evidence that Congressional intent for nonprofit mail was lost in the complexity of Omnibus Rate Case R97-1. This must be rectified. Quoting Faith M. Beamon, USPS Government Relations, in correspondence February 1st with Lester C. Hess, Jr. Past Grand Exalted Ruler, B.P.O. Elks of the U.S.A.:

"The practice of designating certain types of mail for preferred rates was initiated by Congress. In 1993, deficit reduction legislation eliminated federal financial support for nonprofit mailers, but mandated that nonprofit rates be lower than rates for commercial mailers."

This should be brought to the attention of Congress immediately. Members of the B. P. O. Elks have written letters to their Representatives and Senators about nonprofit rate fairness with unknown success so far. We need to bring this new case to light so we can find a reasonable solution.

Sincerely,



Phil Claiborne
Circulation Director

The analysis below is the publisher's own based on the format of postage statement form 3541-nonprofit.

Publication Title: **The Elks Magazine**

Issue Date Feb-99
Frequency 10x
Mailing Date begin/end 1/18/99 - 1/23/99

Nonprofit Rates

Weight (lbs) 0.2147 (Oz.: 3.4)
Advertising % 30.91%

Pound Rate:		Periodicals Preferred Nonprofit 01-10-99					Postage
Zone	Copies	Total lbs	Adv lbs	Rate			
2. DU	-	-	-	\$ 0.155		\$	-
3. SCF	529,055	113,588	35,110	\$ 0.178		\$	6,249.60
4. 1&2	35,469	7,615	2,354	\$ 0.215		\$	506.08
5. 3	84,208	18,079	5,588	\$ 0.229		\$	1,279.73
6. 4	170,933	36,699	11,344	\$ 0.263		\$	2,983.41
7. 5	217,984	46,801	14,466	\$ 0.316		\$	4,571.33
8. 6	67,515	14,495	4,481	\$ 0.371		\$	1,662.28
9. 7	61,895	13,289	4,108	\$ 0.438		\$	1,799.12
10. 8	17,901	3,843	1,188	\$ 0.495		\$	588.05
11. Subtotal	1,184,960	254,411	78,638			\$	19,639.60
12. Non-adv Pounds		175,772	x	0.156	=	\$	27,420.51
13. Total Pound Rate Postage						\$	47,060.11

Piece Rate:		Copies		Rate		Postage	
16. Basic Nonautomation		4,604	\$ 0.251	0.4%	\$	1,155.60	
17. Automation Letters					\$	-	
18. Automation Flats		135	\$ 0.205	0.0%	\$	27.68	
3 Digit Nonautomation		14,901	\$ 0.208	1.3%	\$	3,099.41	
Automation Letters			\$ -		\$	-	
Automation Flats		35,313	\$ 0.184	3.0%	\$	6,497.59	
5 Digit Nonautomation			\$ 0.183		\$	-	
Automation Letters			\$ -		\$	-	
Automation Flats		318,982	\$ 0.162	28.9%	\$	51,675.08	
22. Carrier Rte Basic Car Rte		811,025	\$ 0.113	68.4%	\$	91,645.83	
23. High Density			\$ 0.094		\$	-	
24. Saturation			\$ 0.076		\$	-	
28. Subtotals		1,184,960			\$	154,101.19	
29. Nonadv % Discount	69.09	1,184,960	\$ 0.00044	\$	36,022.31		
30. Del Unit Discount		-	\$ 0.007	\$	-		
31. SCF Discount		529,055	\$ 0.004	\$	2,116.22		
32. Total Piece Rate Discount				\$	(38,138.53)		
33. Total Piece Rate Postage					\$	115,962.66	
34. Total Postage					\$	163,022.77	

(actual 3541-N: \$163,122.85)

Reg rate is this much less than nonprofit rate: \$ 1,841.81

The analysis below is the publisher's own based on the format of postage statement form 3541-Regular.

Publication Title: **The Elks Magazine**

Issue Date Feb-99
Frequency 10x
Mailing Date begin/end 1/18/99 - 1/23/99

If mailed at.. **Regular Rates**

Weight (lbs) 0.2147 (Oz.: 3.4)
Advertising % 30.91%

Pound Rate:		Periodicals Regular 01-10-99				
Zone	Copies	Total lbs	Adv lbs	Rates	Postage	
2. DU		-	-	\$ 0.155	\$ -	
3. SCF	529,055	113,588	35,110	\$ 0.178	\$ 6,249.60	
4. 1&2	35,469	7,615	2,354	\$ 0.215	\$ 506.08	
5. 3	84,208	18,079	5,588	\$ 0.229	\$ 1,279.73	
6. 4	170,933	36,699	11,344	\$ 0.263	\$ 2,983.41	
7. 5	217,984	46,801	14,466	\$ 0.316	\$ 4,571.33	
8. 6	67,515	14,495	4,481	\$ 0.371	\$ 1,662.28	
9. 7	61,895	13,289	4,108	\$ 0.438	\$ 1,799.12	
10. 8	17,901	3,843	1,188	\$ 0.495	\$ 588.05	
11. Subtotal	1,184,960	254,411	78,638		\$ 19,639.60	
12. Non-adv Pounds		175,772	x	0.161	= \$ 28,299.37	
13. Total Pound Rate Postage					\$ 47,938.98	

Piece Rate:		Copies		Rate	Postage	
16. Basic Nonautomation		4,604		\$ 0.294	\$	1,353.58
17. Automation Letters					\$	-
18. Automation Flats		135		\$ 0.248	\$	33.48
3 Digit Nonautomation		14,901		\$ 0.253	\$	3,769.95
Automation Letters					\$	-
Automation Flats		35,313		\$ 0.214	\$	7,556.98
5 Digit Nonautomation				\$ 0.197	\$	-
Automation Letters					\$	-
Automation Flats		318,982		\$ 0.168	\$	53,588.98
22. Carrier Rte Basic Car Rte		811,025		\$ 0.122	\$	98,945.05
23. High Density				\$ 0.103	\$	-
24. Saturation				\$ 0.085	\$	-
28. Subtotals		1,184,960			\$	165,248.02
29. Nonadv % Discount	69.09	1,184,960		\$0.00059	\$	48,302.64
30. Del Unit Discount		-		\$ 0.013	\$	-
31. SCF Discount		529,055		\$ 0.007	\$	3,703.39
32. Total Piece Rate Discount					\$	(52,006.03)
33. Total Piece Rate Postage					\$	113,241.99
34. Total Postage					\$	161,180.97

Date: 2/23/99 Time: 14:14:05

From: Erv Drewek - To: Lee Cassidy

Page 1 of 5

BANTA PUBLICATIONS GROUP

To: Lee Cassidy

From: Erv Drewek

Company: National Federation of Nonprofits

Fax Number: 1-202-628-4383

Total No. Pages: 5

Banta Publications Group - Mailing and Distribution Services	Phone: 816-792-5300	Fax: 816-792-3112
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2/23/99 14:13:40

Here are the postage spreadsheets for the February '99 issue of . We had two versions

Version 1 is called BCT2 and has a quantity of 874,587. Version 2 is called BCT3 and has a quantity of 30,126.

Please call if you have any questions.

Erv

Date: 2/23/99 Time: 14:16:07

From: Env Drewak - To: Lee Cassidy

Page 5 of 5

BANTA Publications Group - Mailing & Distribution Services

02/19/99

Periodicals Postage Estimate

Regular Rates

Publication: LONG PRAIRIE MN 563
 Location: MAR/APR 99
 Issue: BCT3
 Version:

Average Weight per Copy 0.20410
 Advertising Percentage 13.89%
 Nonadvertising Percentage 86.11%

Total Postage **\$3,896.39**

Pound Rate (Per pound or fraction)								
Zone	Copies	%	Pounds	Ad. lbs.	Rate	Postage	Total	
1. Delivery Unit	0	0.00%	0	0	0.155	\$0.00		
2. SCF	0	0.00%	0	0	0.178	\$0.00		
3. 1 & 2	1	0.00%	0	0	0.215	\$0.01		
4. 3	9	0.03%	2	0	0.229	\$0.06		
5. 4	27,137	90.08%	5,539	769	0.263	\$202.33		
6. 5	2,993	9.04%	605	84	0.316	\$26.54		
7. 6	12	0.04%	2	0	0.371	\$0.13		
8. 7	3	0.01%	1	0	0.438	\$0.04		
9. 8	1	0.00%	0	0	0.485	\$0.01		
10. Subtotals	30,126		6,149	854		\$229.12		
11. Nonadvertising Pounds		Nonadv. lbs.	5,295		0.161	\$852.44		
12.			Total Pound Rate Postage (Lines 10 + 11)					\$1,081.56

Piece Rate (Per addressed piece)								
Level		Copies	Pieces	%	Rate	Postage	Total	
13. Basic	Nonbarcoded	85	85	0.28%	0.294	\$24.99		
14. Basic	Barcoded	86	86	0.29%	0.248	\$21.33		
15. 3-digit	Nonbarcoded	545	545	1.81%	0.253	\$137.89		
15a. 3-digit	Barcoded	1,579	1,579	5.24%	0.214	\$337.91		
16. 5-digit	Nonbarcoded	395	395	1.31%	0.197	\$77.82		
16a. 5-digit	Barcoded	8,658	8,658	28.74%	0.168	\$1,454.54		
17. Carrier Route	Basic	18,778	18,778	62.33%	0.122	\$2,290.92		
18. Subtotals		30,126	30,126			\$4,345.30		
19. Nonadvertising Discount	(Nonadv. % x \$0.0055 x qual. post.)				\$1,530.85			
20. DU Discount	U DU pieces x \$0.13				\$0.00			
21. SCF Discount	0 SCF pieces x \$0.007				\$0.00			
22. Total Piece Rate Discount (Lines 19 + 20 + 21)						\$1,530.85		
23.					Total Piece Rate Postage (Lines 18 - 22)			\$2,814.44
24.					Total Postage (Lines 12 + 23)			\$3,896.39
PS Form 3841-R Facsimile							Postage Per Copy	\$0.129337

Date: 2/23/99 Time: 14:15:37

From: Eric Drewak - To: Lee Cassidy

Page 4 of 5

BANTA Publications Group - Mailing & Distribution Services

02/16/99

Periodicals Postage Estimate
Nonprofit Rates

Publication: LONG PRAIRIE MN 563
 Location: MAR/APR 99
 Issue: BCT3
 Version: BCT3

Average Weight per Copy 0.20410
 Advertising Percentage 13.89%
 Nonadvertising Percentage 86.11%

Total Postage \$3,953.31

Pound Rate (Per pound or fraction)

Zone	Copies	%	Pounds	Ad. lbs.	Rate	Postage	Total
1. Delivery Unit	0	0.00%	0	0	0.155	\$0.00	
2. SCF	0	0.00%	0	0	0.178	\$0.00	
3. 1 & 2	1	0.00%	0	0	0.216	\$0.01	
4. 3	0	0.03%	2	0	0.229	\$0.06	
5. 4	27,137	90.08%	5,539	769	0.263	\$202.33	
6. 5	2,953	9.84%	605	84	0.316	\$26.54	
7. 6	12	0.04%	2	0	0.371	\$0.13	
8. 7	3	0.01%	1	0	0.436	\$0.04	
9. 8	1	0.00%	0	0	0.495	\$0.01	
10. Subtotals	30,126		6,149	854		\$229.12	
11. Nonadvertising Pounds		Nonadv. lbs.	5,295		0.156	\$826.97	
12.						Total Pound Rate Postage (Lines 10 + 11)	\$1,056.09

Piece Rate (Per addressed piece)

Level	Copies	Pieces	%	Rate	Postage	Total
13. Basic Nonbarcoded	85	85	0.28%	0.251	\$21.34	
14. Basic Barcoded	85	85	0.29%	0.205	\$17.83	
15. 3-digit Nonbarcoded	545	545	1.81%	0.208	\$113.36	
15a. 3-digit Barcoded	1,579	1,579	5.24%	0.184	\$290.54	
16. 5-digit Nonbarcoded	395	395	1.31%	0.183	\$72.29	
16a. 5-digit Barcoded	8,658	8,658	28.74%	0.162	\$1,402.60	
17. Carrier Route Basic	18,778	18,778	62.33%	0.113	\$2,121.91	
18. Subtotals	30,126	30,126			\$4,039.66	
19. Nonadvertising Discount (Nonadv. % x \$,0004 x qual. pcs.)				\$1,141.43		
20. DU Discount (DU pieces x \$,007)				\$0.00		
21. SCF Discount (SCF pieces x \$,004)				\$0.00		
22. Total Piece Rate Discount (Lines 19 + 20 + 21)					\$1,141.43	
23.				Total Piece Rate Postage (Lines 18 - 22)		\$2,898.23
24.				Total Postage (Lines 12 + 23)		\$3,953.31
PS Form 3511-R Facsimile				Postage Per Copy		\$0.131226

Date: 2/23/99 Time: 14:15:05

From: Eric Drowak - To: Lee Cassidy

Page 3 of 5

BANTA Publications Group - Mailing & Distribution Services

02/18/99

Periodicals Postage Estimate

Regular Rates

Publication: LONG PRAIRIE MN 563
 Location: MAR/APR 99
 Issue: BCT2
 Version:

Average Weight per Copy 0.20410
 Advertising Percentage 13.89%
 Nonadvertising Percentage 86.11%

Total Postage \$111,464.54

Pound Rate (Per pound or fraction)							
Zone	Copies	%	Pounds	Ad. lbs.	Rate	Postage	Total
1. Delivery Unit	0	0.00%	0	0	0.155	\$0.00	
2. SCF	4,341	0.50%	886	123	0.178	\$21.91	
3. 1 & 2	97,723	11.17%	19,945	2,770	0.215	\$595.64	
4. 3	134,140	15.34%	27,378	3,803	0.229	\$870.64	
5. 4	269,658	30.83%	55,037	7,645	0.263	\$2,010.55	
6. 5	162,299	18.56%	33,125	4,001	0.316	\$1,453.95	
7. 6	151,023	17.27%	30,824	4,281	0.371	\$1,688.41	
8. 7	52,880	6.05%	10,704	1,469	0.438	\$656.71	
9. 8	2,514	0.28%	513	71	0.495	\$35.28	
10. Subtotals	874,687		178,503	24,794		\$7,233.28	
11. Nonadvertising Pounds		Nonadv. lbs.	153,708		0.161	\$24,747.17	
12.			Total Pound Rate Postage Lines 10 + 11				\$31,980.45

Piece Rate (Per addressed piece)							
Level		Copies	Pieces	%	Rate	Postage	Total
13. Basic	Nonbarcoded	1,204	1,204	0.14%	0.294	\$353.98	
14. Basic	Barcoded	274	274	0.03%	0.248	\$67.05	
15. 3-digit	Nonbarcoded	7,694	7,694	0.90%	0.263	\$1,997.18	
16a. 3-digit	Barcoded	29,964	29,964	3.43%	0.214	\$6,412.30	
16. 5-digit	Nonbarcoded	5,255	5,255	0.60%	0.197	\$1,035.24	
16a. 5-digit	Barcoded	278,731	278,731	31.87%	0.168	\$46,826.81	
17. Carrier Route	Basic	551,265	551,265	63.03%	0.122	\$67,254.33	
18. Subtotals		874,587	874,587			\$123,947.78	
19. Nonadvertising Discount	(Nonadv. % x 5.00059 x qual. pcs.)				\$44,433.31		
20. DU Discount	0 DU pieces x 5.013				\$0.00		
21. SCF Discount	4,341 SCF pieces x 5.007				\$30.39		
22. Total Piece Rate Discount (Lines 19 + 20 + 21)						\$44,463.69	
23.	Total Piece Rate Postage (Lines 18 - 22)						\$79,484.09
24.	Total Postage (Lines 12 + 23)						\$111,464.54
PS Form 3841-R Facsimile					Postage Per Copy		\$0.127448

DANTA Publications Group - Mailing & Distribution Services

02/17/99

Periodicals Postage Estimate
Nonprofit Rates

Publication: LONG PRAIRIE MN 563
 Location: MAR/APR 99
 Issue: BCT2
 Version:

Average Weight per Copy 0.20410
 Advertising Percentage 13.89%
 Nonadvertising Percentage 86.11%

Total Postage \$113,980.57

Pound Rate (Per pound or fraction)

Zone	Copies	%	Pounds	Adj. lbs.	Rate	Postage	Total
1. Delivery Unit	0	0.00%	0	0	0.155	\$0.00	
2. SCF	4,341	0.50%	886	123	0.178	\$21.91	
3. 1 & 2	97,723	11.17%	19,945	2,770	0.215	\$595.64	
4. 3	134,140	15.34%	27,378	3,803	0.229	\$870.84	
5. 4	269,859	30.83%	55,037	7,645	0.263	\$2,010.55	
6. 5	182,269	18.56%	33,125	4,601	0.316	\$1,453.95	
7. 6	151,023	17.27%	30,824	4,281	0.371	\$1,558.41	
8. 7	52,888	6.05%	10,794	1,489	0.438	\$650.71	
9. 8	2,514	0.29%	513	71	0.495	\$35.20	
10. Subtotals	874,587		178,503	24,794		\$7,233.28	
11. Nonadvertising Pounds		Nonadv. lbs.	153,769		0.156	\$23,978.62	
12.			Total Pound Rate Postage (Lines 10 + 11)				\$31,211.91

Piece Rate (Per addressed piece)

Price Rate (Per addressed piece)						
Level	Copies	Pieces	%	Rate	Postage	Total
13. Basic Nonbarcoded	1,204	1,204	0.14%	0.251	\$302.20	
14. Basic Barcoded	274	274	0.03%	0.205	\$56.17	
15. 3-digit Nonbarcoded	7,894	7,894	0.90%	0.200	\$1,541.85	
15a. 3-digit Barcoded	29,964	29,964	3.43%	0.184	\$5,513.38	
16. 5-digit Nonbarcoded	5,255	5,255	0.60%	0.183	\$961.67	
16a. 5-digit Barcoded	278,731	278,731	31.87%	0.162	\$45,154.42	
17. Carrier Route Basic	551,265	551,265	63.03%	0.113	\$62,292.85	
18. Subtotals	874,587	874,587			\$115,922.73	
19. Nonadvertising Discount	(Nonadv. % x \$0.0044 x qual. pcs.)			\$33,136.70		
20. DU Discount	0 DU pieces x \$0.007			\$0.00		
21. SCF Discount	4,341 SCF pieces x \$0.004			\$17.36		
22. Total Piece Rate Discount (Lines 19 + 20 + 21)					\$33,154.07	
23.	Total Piece Rate Postage (Lines 18 - 22)					\$82,768.67
24.	Total Postage (Lines 12 + 23)					\$113,980.57
PS Form 3811 A Facsimile					Postage Per Copy	\$0.130325

United States House of Representatives
Committee on Government Reform and Oversight
Subcommittee on the Postal Service

Hearing on H.R. 22
The Postal Modernization Act of 1999

March 4, 1999

STATEMENT OF DAVID F. STOVER
ON BEHALF OF THE
GREETING CARD ASSOCIATION

Statement of David F. Stover
On Behalf of the
GREETING CARD ASSOCIATION

United States House of Representatives
Committee on Government Reform and Oversight
Subcommittee on the Postal Service

March 4, 1999

Mr. Chairman and Members of the Subcommittee,

The Greeting Card Association is pleased to present this testimony on H.R. 22, the Postal Modernization Act of 1999. The Greeting Card Association's membership consists of the publishers of the seven billion greeting cards Americans exchange every year. Some five billion of those cards are sent through the U.S. mail. Practically all move as single-piece First Class letters. Consequently, America's families and businesses, and the greeting card publishers who help them exchange their personal messages, have a strong interest in preserving a successful universal postal system. The GCA, through its 58-year history, has championed the citizen mailer -- the individual citizen who uses the mails to communicate with family and friends. The GCA has spoken on behalf of the citizen mailer before Congress as well as in the course of a continuous relationship with the postal agencies.

GCA believes strongly that a healthy Postal Service is vital to our industry and to the individual customers who use the mails for personal communication, and that any postal legislation must protect the citizen mailer. Such protection was an indispensable element of the original Postal Reorganization Act of 1970.¹ We have therefore evaluated H.R. 22, and recent Postal Service proposals, from the standpoint of the citizen mail user, and more particularly the user

of single-piece First-Class letter mail.² Our basic aim is to insure that the rates the citizen mailer must pay remain fair and equitable.

I. H.R. 22

A. *Some beneficial features of H.R. 22.* We commend Chairman McHugh for his efforts to address a broad spectrum of widely differing views. The bill, H.R. 22, appears to try to balance two sets of conflicting goals. On the one hand it calls for substantial deregulation of postal rates and for expanded opportunities for the Postal Service to try new, more entrepreneurial ventures. On the other hand, it seeks to preserve at least some degree of fairness and protection of captive postal customers, such as the citizen mailer, and to impose on the Postal Service meaningful incentives to improve its general productivity.

Besides attempting to preserve this general balance, H.R. 22 proposes beneficial changes in several specific areas:

- a strengthened Postal Regulatory Commission with effective information-gathering powers;
- a mandate for independent study of the labor relations system;
- a streamlined and more flexible financial management process for the Postal Service, and
- specification of appropriate qualifications for USPS Directors.

Like the Main Street Coalition for Postal Fairness, of which the GCA is a member, we endorse these reforms.

More generally, GCA is especially supportive of the efforts made in H.R. 22 to protect mailers with no alternatives, of whom First-

Class letter mailers are the largest group; to keep rates fair; to prevent disproportionate burdens of overhead cost from being shifted onto mailers who have no alternatives; and to help the Service become more productive.

B. *Questions concerning H.R. 22.* After following the evolution of this proposal over several years, GCA is not convinced that the broad "deregulation-plus-price-cap" approach is the right one for the U.S. Postal Service. The GCA believes that adoption of this approach would prove detrimental to the Postal Service's mission of binding the Nation together, because it would have a harmful effect on the First-Class mailer. In particular, we are concerned that

- ▶ the "baskets" into which H.R. 22 would divide "noncompetitive" mails would harm the citizen mailer;
- ▶ the bill would facilitate exploitation of the letter-mail monopoly;
- ▶ the long tradition of universal service would be unnecessarily called in question; and
- ▶ for basic structural reasons, the price cap would prove ineffective.

1. *The problem of noncompetitive mail "baskets."* First, let us call attention to a major flaw in the way H.R. 22 treats noncompetitive mail classes -- that is, the types of mail used by the citizen mailer.

H.R. 22 divides noncompetitive mail into "baskets" and, in particular, bifurcates First Class into single-piece and bulk baskets. We see no need for this division, especially as H.R. 22 has evolved over the past few years. Dividing First Class letter mail into two baskets is especially inappropriate since all of it serves

the same purpose - message communication - and since any cost differences among groups of First-Class letters can be, and are, reflected in cost-based discounts. This issue was thoroughly debated in the 1995 "reclassification" case, and the PRC decided against splitting First-Class letters into separate bulk and single-piece subclasses.³ Bifurcating First Class could serve little purpose other than to invite discrimination. The ordinary citizen, once again, would be taxed for the benefit of large-volume mailers.

2. *Exploitation of the letter monopoly.* Moreover, the USPS has always been considered a vital public service and not a profit-maximizing enterprise.⁴ For this reason, among others, it has been granted a statutory monopoly on letter mail. We doubt that, as a profit-seeking enterprise, it could avoid exploiting this monopoly. Such exploitation of the letter monopoly, of course, would hit the citizen mailer particularly hard.

3. *The universal service study.* There is little reason for a study of what degree of universal postal service is needed - and certainly no reason to delegate such a study to the Postal Service. What level of universal service America needs is a Congressional question. It should not be decided by an interested agency likely to concentrate excessively on cost and net revenue issues.⁵

4. *Basic structural problems.* Substantial deregulation of rates, coupled with a limit on total revenues - that is, a price cap - may work in some regulated industries whose basic characteristics are very unlike those of the USPS. The same approach applied to the Postal Service, however, would prove to be ineffective.

First, the Postal Service - unlike utilities in the private sector - has no "residual claimant" in the form of stockholders who seek dividends and who, if disappointed, can remove the management deemed to be at fault. We question whether transferring the "residual claimant" role to postal managers and employees, who are

themselves the largest part of the cost picture, can be expected to produce similar pressures for greater cost efficiency.

Second, the Service is labor-intensive. Though it has invested heavily in automation, it has little prospect of the kind of technological revolution that made deregulation and price caps plausible in the telephone industry. Price caps work easily when the industry is experiencing rapid declines in unit cost -- for example, as the computers now underpinning telecommunications become simultaneously cheaper and more powerful.

For all these reasons, the GCA is unable to support these key aspects of H.R. 22.

II. Amendments proposed by the Postal Service

In December 1998 and again in January of this year, the Postal Service issued a series of proposed amendments to H.R. 22. The GCA believes that these amendments, if accepted, would seriously harm the citizen mailer -- while doing nothing to make the Postal Service more efficient. The USPS changes would facilitate cost shifting, from competitive to noncompetitive mails, and not cost reduction. They would deprive the price cap of its justification -- which is that it promotes efficiency and cost reduction -- and convert it into a largely automatic mechanism for passing on costs through annual rate increases. The theory of price caps requires that the enterprise subject to the cap must face a risk of financial loss if its costs are not adequately controlled. The USPS amendments would eliminate that risk -- and thus nullify even the theoretical arguments in favor of price-capped deregulation.

Since we do not know the level of consideration that the Postal Service amendments may receive in the future, we have attached our detailed comments on them as an Appendix to this statement.

III. Conclusion

H.R. 22 represents a praiseworthy attempt to balance the existing postal tradition of public service, consumer protection, and fairness to all mailers with the concept of freedom for the Postal Service to expand, innovate, and engage in creative pricing of its service - all subject to a standing incentive to control its costs. The Subcommittee has recognized these needs. Several specific changes - strengthening the PRC, studying the labor relations process, financial flexibility for the USPS, and definition of Directors' qualifications - should be moved forward.

There are, however, several aspects of the bill that the GCA cannot support. The noncompetitive mail baskets, and especially the bifurcation of First Class, would be harmful to the citizen mailer, and would invite discriminatory pricing. We are gravely concerned by the threat to the historic concept of universal postal service implied in the proposed "study" of the necessary scope and quality of universal service. We seriously doubt that - given the basic structure of the Postal Service - the price cap would be an effective constraint on costs.

We deeply appreciate the opportunity to present to the Subcommittee the views of the Greeting Card Association.

1. For example:

. . . The temptation to resolve the financial problems of the Post Office by charging the lion's share of all operational costs to first class is strong; that's where the money is. The necessity for preventing that imposition upon the only class of mail which the general public uses is one of the reasons why the Postal Rate Commission should be independent of operating management. . . .

91st Cong., 2d Sess., S. Rep. No. 91-912 (June 3, 1970), p. 13

(italics added).

2. Testifying in the Senate, the President of GCA noted that

. . . first class mail is specific to each person
First class mail is important to people. The USPS's own
household diary studies confirm this. . . . it is the
valued personal correspondence from people dear to us that
gets our first attention.

Statement of Hamilton Davison before the Post Office and Civil
Service Subcommittee of the Senate Committee on Governmental Affairs,
March 14, 1996, p. 3.

3. *Mail Classification Reform I*, PRC Docket No. MC95-1, January 26,
1996).

4. See 39 U.S.C. § 101(a).

5. Decisions on what level of service constitutes "universality" for
a particular class of mail also entail judgments regarding the
allocation of costs among classes and, consequently, the rates they
must pay. For instance, if it were determined that only Express Mail
and Priority Mail required Saturday delivery to comply with the
universality mandate, the costs of Saturday delivery must be
estimated - a process likely to involve much arbitrariness - and then
could be allocated entirely to them, even if Saturday delivery
continued to be provided for all mail.

APPENDIX - THE POSTAL SERVICE'S PROPOSED AMENDMENTS

This Appendix to the statement on behalf of the Greeting Card Association analyzes in detail some features of the Postal Service's proposed amendments to H.R. 22.

A. *Postal Service proposals in relation to the goals of H.R. 22 - the price cap.* H.R. 22 recognizes that the justification for deregulation of rates subject to a price cap is the resulting incentive to reduce costs and improve efficiency which a properly-designed price cap creates. By providing for a negative adjustment factor - that is, an adjustment that constrains the annual maximum rate to increase more slowly than the Consumer Price Index - H.R. 22 seeks to establish this incentive.

The Postal Service amendments would do away with the efficiency incentive in the price cap, first, by effectively prohibiting the negative adjustment factor. The Postal Regulatory Commission could establish such a negative "X factor" only if it could show that the Service's productivity gains would be greater, during the entire prospective rate cycle, than those in an altogether different economic measure - the Non-Farm Multifactor Productivity Index. This would have to be shown not by normal administrative law standards but by "compelling evidence."¹ On the other hand, a positive X factor - allowing rates to rise faster than the CPI - would still be available to the USPS under the broadly-stated criteria of H.R. 22, and without any extraordinary standard of proof.

In the second package of USPS amendments, released last month, the price cap is further diluted. Without revising its previous suggestions, the Service now asks that the adjustment factor also be able to reflect "exogenous" cost changes. From the Service's

explanation, this appears to refer to cost increases -- and does not allow the rate maximums to be lowered in the event of an exogenous cost reduction. Since the exogenous costs apparently need not be related to noncompetitive mail only, it seems that cost increases relating to competitive mail could be passed through to customers of the noncompetitive classes -- since only they are affected by the price cap. Moreover, suppose that an exogenous cost were only temporary. If both the adjustment factor and the rates it controls were changed to reflect that temporary cost, then even after it disappeared noncompetitive mail rates would continue as if it were still present.

Finally, the Service's proposal simply dodges the question whether, in a price-cap system which works by imposing risk on the utility in exchange for price deregulation, there is any place for an no-fault insurance policy against exogenous costs. Such costs are not unknown in the private sector, and managements faced with competition routinely look for ways to mitigate them by means other than price hikes.

When the Postal Service is less efficient than it can and should be, all mailers are burdened -- the mass business mailer as well as the ordinary citizen. The one-sided weakening of the price cap proposed in the USPS amendments is thus dangerous to all mail users. When it is combined with substantial ratesetting flexibility -- provided for in both H.R. 22 and the Postal Service's suggested amendments -- there is an additional threat of discrimination against the citizen mailer who lacks alternatives.

B. Postal Service proposals in relation to the goals of H.R. 22 -- fairness in allocation of institutional costs. A particularly beneficial initiative in H.R. 22 is the proposal that competitive mail classes contribute to institutional costs in the same proportion as noncompetitive mails. This provision explicitly seeks fairness in

the allocation of overhead costs to all groups of mailers.² The USPS proposals, however, would

- ▶ "Phase out" the requirement over five years; and
- ▶ Distort its application by mandating the artificial exclusion of substantial costs - including, particularly, transportation, a costly aspect of competitive mail classes.³

These proposals seem clearly aimed at benefiting competitive mail classes at the expense of the captive customer. The Service's explanation of its proposal appears to misread the intent of H.R. 22; it states that parity is not necessary since cross subsidy can be prevented by other provisions in the bill. But as we have noted, the purpose of parity is not merely prevention of cross subsidy in the technical economic sense but fairness in the sharing of costs between competitive mail classes and the core services for which the USPS either has a legal monopoly or faces little effective competition. Those core services are the ones used by the ordinary citizen mailer.

C. USPS-proposed changes in the processes that H.R. 22 would establish. Besides changes in substantive law, H.R. 22 made several useful additions to the powers and responsibilities of the PRC - additions that would help the PRC assure fair treatment of the citizen mail user. The USPS proposals would instead weaken the Commission's role. They would, for instance -

- ▶ eliminate the PRC's role in making regulations against unfair competition⁴;
- ▶ eliminate the baseline rate case, which would be the last opportunity to begin the rate escalation on the basis of current, tested, realistic cost and other data⁵; and

- do away with the ability of the PRC, acting on a mail user's request or on its own motion, to initiate a proceeding for the transfer of a service between the competitive and noncompetitive categories, would be abolished: only the USPS could start such a proceeding.⁶

The Postal Service amendments seek to shield USPS cost and other data from public scrutiny to a much greater extent than H.R. 22 would allow -- notwithstanding the evident effort of the drafters to accommodate USPS concerns. For example: H.R. 22 provides that every year the USPS would report to the PRC on "costs, revenues, and rates in sufficient detail to demonstrate that the rates . . . complied with all applicable requirements of this title."⁷ As rewritten in the Service's proposal, this provision would require only reports on "costs, revenues, rates for noncompetitive products, and basic rates for competitive products in sufficient detail to demonstrate compliance with the requirements of sections 3732, 3743, and 3744 of this title."⁸ ("Basic rates," the Service explains, means "published tariffs.") This amendment is designed, according to the Service, to insure that "commercially sensitive pricing data regarding specific customers" remains undisclosed. This USPS amendment raises the question of how the compliance of an individual negotiated rate with any legal requirements applicable to it could be assessed, absent disclosure to the PRC and affected parties of cost, rate, and revenue data for the service agreement in question.

D. *The proposed study of universal service.* While GCA does not believe that a delegated study of the need for universal service is necessary or desirable, it must be recognized that the USPS amendments would make this project even more problematical. H.R. 22 required the PRC to report annually on the estimated cost of postal service in areas where, absent the universality requirement, the USPS would not offer the service or would offer it at a statutorily unacceptable level. The USPS amendments, however, would require that PRC reports on the cost of universal service specific defer to the

Postal Service's own recommendations on scope and standards for universal service. As we noted earlier, the USPS must be concerned with costs and net revenues even in studying universality of service -- where broader policy concerns should govern. Making USPS conclusions binding on the otherwise-independent PRC simply compounds the problem.

E. Conclusion. The USPS-proposed changes to H.R. 22 would defeat its main purposes. They would dilute H.R. 22's efficiency incentive to the vanishing point. They would facilitate unfair shifting of costs from competitive to noncompetitive mail users, including "Aunt Minnie." They would jettison the requirement that competitive services make an equitable -- not just a minimal -- contribution to institutional costs. They would reduce the public oversight role of the PRC, limit public access to data on USPS operations, costs, and revenues, and would call into question the historic requirement of universal service even more sharply -- and with more lasting consequences -- than does H.R. 22. The general thrust of the Service's amendments conflicts with the basic concept that ratemaking flexibility under a price cap requires the enterprise subject to the cap to face a risk of financial loss if its costs are not adequately controlled. The amendments would eliminate that risk -- and thus nullify even the theoretical arguments in favor of price-capped deregulation. None of these changes are calculated to benefit the captive postal customer.

1. USPS legislative proposal of December 1998, p. 18. It is noteworthy that the USPS proposal would allow the Service to retain all the benefits of any productivity gains it experienced which were greater than those reflected in the CPI but less than those which the PRC could establish would appear in the Non-Farm Multifactor index for future years.

The USPS supports its proposal by arguing that it would still be responsible for equaling the "ordinary" gains in productivity "already embedded" in the CPI. It is not clear that changes in the

CPI bear any consistent relation to changes in productivity. Comparison of the CPI-U and certain broad productivity indices shows little or no correlation.

2. The August 1998 section-by-section analysis - covering language identical to that in the present H.R. 22 - makes this quite clear:

The Postal Service enjoys the rights and powers of a government entity, along with its statutory monopoly over the delivery of letter mail. Therefore, the Service should not compete with private companies while using non-competitive products to unfairly pay for its overhead costs; in other words, under the cost coverage rule, the Postal Service will not be allowed to load a disproportionate share of costs on users of non-competitive products.

The equal cost coverage rule of the amendment is a fair and equitable rule that (1) allows the Postal Service flexibility to price individual competitive products as it sees fit . . . while (2) at the same time preventing the Postal Service from loading an unfair proportion of overhead costs onto its noncompetitive customers. . . .

House of Representatives Committee on Government Reform and Oversight, Subcommittee on the Postal Service, *Section-by-Section Analysis, H.R. 22* (August 21, 1998), p. 17 (italics added).

3. By lowering the attributable cost base of a competitive mail class, its apparent contribution to institutional costs, at any given rate, becomes larger. Parity of contributions, therefore, would require reduction of competitive rates and increases in noncompetitive rates if cost exclusions disproportionately reduced the nominal attributable cost of competitive mails. H.R. 22 also allows for exclusions of this kind, but commits the decision to the expert judgment of the PRC.

4. USPS legislative proposal of December 1998, p. 33.

5. Id., pp. 3-5.

6. Id., p. 9.

7. H.R. 22, proposed § 3772(a)(1).

8. USPS legislative proposal of December 1998, p. 27 (italics added).



**STATEMENT OF GUY H. WENDLER
ON BEHALF OF AMERICAN BUSINESS PRESS
BEFORE THE
SUBCOMMITTEE ON THE POSTAL SERVICE
HOUSE COMMITTEE ON GOVERNMENT REFORM**

March 4, 1998

My name is Guy H. Wendler, and it is a privilege to appear before this subcommittee on behalf of the American Business Press, a founding member of the Main Street Coalition. I am the president of Stamats Communications, Inc., a family-owned and operated publishing and marketing communications company based in Cedar Rapids, Iowa, and I serve as the Chairman of the ABP Washington Legal Committee.

Stamats Communications publishes four periodicals mailed at the Periodicals rates: Buildings, Commercial Building, Meetings in the West, and Meetings South with circulations of 57,000, 75,000, 25,000 and 17,500 respectively, typical of the specialized, business publications mailed by ABP members. In addition, Stamats publishes directories and higher education marketing newsletters, and we assist colleges and universities in their marketing efforts by providing research and consulting services and both print and electronic marketing materials.

American Business Press is an association of the nation's leading business-to-business and professional periodicals, and it has been an active participant in postal matters for decades. Since the passage of the Postal Reorganization Act in 1970, it has participated in every rate case before the Postal Rate Commission, and I have testified in two of those proceedings. Throughout its history, ABP has promoted a strong, nationwide postal service and has sought to protect the interests of the smaller circulation periodicals that are representative of its membership. We estimate that ABP's more than one hundred members spend approximately \$200,000,000 annually on postage to deliver the nearly one thousand periodicals that they produce.

As publishers of small circulation periodicals, ABP members rely almost exclusively on the Postal Service for delivery, and we would thus be alarmed at the prospect of a Postal Service with declining revenues and levels of service. Just as the Postal Service has been given the responsibility to "bind the nation together," so too do ABP member publications bind together the nation's businesses. The crucial and unique role that our publications play in assisting American businesses in the ever more competitive world economy would be jeopardized by a deteriorating Postal Service, so we do not take lightly the claims that far reaching postal "reform" is necessary to avoid that circumstance.

ABP therefore does not want to see a Postal Service weakened by diversion of profitable First-Class mail to electronic media or by an inability to compete for core portions of its product line, because the implications of such a Postal Service would be devastating to our businesses and, we believe, to American business in general. But we cannot support cures for the alleged illness that are only marginally, if at all, directed to these supposed ills and that would in all likelihood produce for our small segment of the publishing industry the crippling rate increases they are intended to prevent. We see in H.R. 22—and for more so in the amendments proposed by the Postal Service—a shift in ratemaking authority over periodicals and other non-competitive classes that does nothing to respond to electronic diversion but appears to be little more than a power grab by the Postal Service.

ABP will focus the remainder of these remarks on ratemaking; the Main Street Coalition will address H.R. 22 in a comprehensive fashion. But before turning to the specifics of the bill, I would like to present a bit of important history is.

Smaller circulation periodicals of the type published by ABP members have long been the target of proposed USPS changes in periodical rate design. For example, on more than one occasion in recent years, the Postal Service has attempted to eliminate the flat, unzonated editorial rate that has been the bedrock of periodical rates since the founding of the Republic and that has given readers throughout the nation equal access to information. Each time, ABP has opposed that change, and each time the Postal Rate Commission has said "no." Several years ago, the Postal Service proposed another change in rate design that would have adversely affected only smaller circulation periodicals when it requested a rate increase for magazines without large enough circulation to prepare their mail on pallets, in order to fund a rate decrease for those able to do so. Again, the Postal Rate Commission heard evidence in opposition from ABP, and again it said "no."

But these efforts by the Postal Service to tilt its rates in favor of mass-circulation magazines pale in comparison to its 1995 "reclassification" request. In that case, one that was allegedly revenue neutral, the Postal Service proposed a bifurcation of periodicals such that a few hundred of the largest would enjoy double-digit rate *decreases*, while twenty-thousand or so publications would suffer *increases* of up to 20% and more. And yet again, ABP had the opportunity to present evidence and policy

argument opposing this massive change, and again the Postal Rate Commission said "no."

It is beyond dispute that, but for the authority of the Postal Rate Commission and the courageous way in which it has exercised that authority, the rates faced by ABP periodicals and thousands of others would be much, much higher—so high, in fact, that existing magazines would have folded and, at least as importantly, start-up magazines devoted to start-up industries may never have been launched. Now, in the name of efficiency and responsiveness to market conditions, we are being asked to give up the protections that have been essential to our survival in exchange for an enhanced ability by the Postal Service to respond to threats that are incipient, at best, and for a system of constraints on the ability of a monopolist to set its own rates. We are not convinced that the trade is a good one.

H.R. 22 recognizes that when a monopolist is given ratemaking authority, there must be a series of limitations and constraints. It attempts to craft those constraints with an overall price cap (that may not effectively cap prices) and a band within which individual prices for individual products must fall. As we understand the specifics of H.R. 22—and such understanding does not come easily—each individual rate cell applicable to each product must move up or down within what we have called a "deviation band" of plus or minus two percentage points of the CPI-X price cap, or a range of four percentage points.

Even as this crucial provision has evolved and been interpreted, its real world application is far from clear. In the 1997 rate case, for example, the Postal Service proposed, and the entire industry supported, a new rate category for Periodical mail sorted to three zip code digits. How, if at all, could this change be effected under H.R. 22, and if it could be, what would happen if a change were sought by the Postal Service that is similar in form but far less innocuous? More importantly, for how long will rates remain just and reasonable, or fair and equitable, if every rate element is constrained within a tight band, while individual categories of costs move by varying amounts or even in opposite directions?

Apart from these important though technical details concerning how H.R. 22 would work, we are even more concerned not with how it would work but with what the Postal Service can do with it. It appears to ABP that, especially if (or should we say when) we return to a period of higher inflation, with a higher CPI-X factor, the Postal Service will be able under H.R. 22 to accomplish the zoned editorial rate, the discriminatory sack surcharge, and the "revenue neutral" reclassification with its 17% average rate increase rejected by the Postal Rate Commission as in violation of the Postal Reorganization Act's mandate of fair and equitable rates. The only question is how long it will take.

We note that in response to the individual rate constraints set forth in H.R. 22, the Postal Service has proposed a significantly less restrictive set of constraints. While

H.R. 22 is troubling, the Postal Service proposal is frightening. In both cases, we suggest, the problem is in large part systemic. Ideally, the rate setter should be an entity that is inherently trustworthy, and that entity should have substantial discretion to consider costs and other factors in order to establish rates that are fair and equitable. That is the present system. In H.R. 22 and the Postal Service version thereof, rate setting authority would be transferred to the Postal Service—a powerful monopoly that I do not believe is particularly interested in setting rates fairly for businesses such as ours—so the thrust of the bill is to circumscribe its authority and substantially restrict its discretion. ABP respectfully suggests that more work is needed to determine whether putting a strait jacket on the fox that guards the hen house can truly do justice to either the fox or the hens.

I have focused thus far on the area of greatest concern to ABP, the details of the rate-setting mechanism. I would like to comment briefly as well on another rate issue, the overall level of Periodicals rates, and the prospects for rate relief under H.R. 22. Over the past six months, ABP has participated actively in a joint publishing industry/Postal Service task force formed to study why the claimed costs of processing periodicals have skyrocketed in recent years, rising much more rapidly than the costs of processing similar mail in other classes and, despite greater mailer worksharing, more rapidly than Postal Service wage rates. Should this effort be successful in stopping or even reversing this trend, periodical mailers in a cost-based rate environment would almost certainly enjoy the rate benefits of declining costs. Under H.R. 22, however, there would be no incentive for the Postal Service to allow that result, and every incentive to secure maximum permissible revenues from this mail over which it has a de facto monopoly.

In sum, ABP has for many years devoted substantial resources to protect its members against unwarranted postal rate increases and has done so first before Congress and, since 1970, in the crucible of rate cases before the Postal Rate Commission. We have not yet seen a better system. If this Committee believes that the possibility of electronic diversion and the alleged need of the Postal Service to be more responsive to competition for that small portion of its business that is truly competitive require far reaching structural changes, we will work with you to accomplish statutory solutions to these specific problems. But we urge you to carefully consider not destroying the mechanisms that have worked well in those areas of the Postal Service's business that are still a monopoly, such as periodicals.

I appreciate the opportunity to appear before you.

Testimony of Kenneth B. Allen

Executive Vice President and CEO

National Newspaper Association

Hearing on H.R. 22, "The Postal Modernization Act of 1999"
March 4, 1999

Before The Subcommittee on the Postal Service of the House
Government Reform and Oversight Committee

INTRODUCTION

This testimony is submitted on behalf of the National Newspaper Association in order to comment on the Postal Modernization Act of 1999, H.R. 22, as introduced by Chairman John McHugh of the Postal Subcommittee of the House Government Reform and Oversight Committee, as well as the recent proposed amendments to this legislation offered by the United States Postal Service.

The National Newspaper Association, established in 1885, represents nearly 4,000 daily and weekly newspapers nationwide. Our members are customers of the United States Postal Service not only for First Class mail, but also for the Periodicals category of mail--both regular rate and within county Periodicals mail. Most of our members use the Postal Service as their delivery agent rather than using a private delivery system. Using the Postal Service allows newspapers to focus on their product rather than upon distribution. For many of our members, there is no alternative to the United States Postal Service for the delivery of their newspaper. Many of our members have also taken the opportunity presented by advertising mail rates and have developed new products under the Standard A mail rate.

Community newspapers primarily focus on local news and information essential to their local community. Our members are "refrigerator news"—most likely to be tacked up and saved on the refrigerator door by readers. Our members also have a proud history of serving their local communities by working in cooperation with local business and by providing commercial information through advertising that ties the community together. For many of our members, they have been performing these functions for more than one hundred years and over four generations.

Our greatest partner in this endeavor has been the United States Postal Service. Today, the commitment and dedication of local postal employees to their community and the local newspaper is inspiring and a great untold tale. The United States Postal Service and the local community newspaper touch more lives on a daily basis than any other institutions in the United States. Regardless of what the future holds for the Postal Service due to the widely touted Internet revolution, newspapers will always remain customers of the Postal Service. Therefore, we do not take the issue of reforming the statutes governing the USPS lightly. We are interested in a strong, vital United States Postal Service that provides universal delivery at affordable rates.

OVERVIEW

During the Subcommittee's last hearing on H.R. 22, on February 11, it was not surprising to learn that the Postal Service is reluctant to acquire added regulation. It was also not surprising to hear the Postal Rate Commission argue in favor of added regulations. The underlying task for Congress is to balance out these competing interests and create a system that encourages the Postal Service to effectively and fairly serve all customers—something that cannot happen without reasonable oversight to manage the postal monopoly. Postal reform has been compared to the reform of the telecommunications law in 1996. But the intent of telecommunications reform was to provide consumers with lower prices and more choice in services. The goal of postal reform is to foster the lifespan of the United States Postal Service in a changing communications environment to enable it to continue to provide the intangible—universal service to everyone everywhere. To date, little mention has been made of the postal “consumer” or of Congress's desire to lower postal rates for ratepayers.

Telecommunications reform occurred at a time when computerization dramatically lowered operating costs, permitting the telephone companies to earn record profits even with a price cap. This great technological boon remains largely unavailable in print message delivery which, by its very nature, requires massive numbers of human beings to operate.

We do not disagree with the intent of postal reform and strongly support the desire to protect and foster our nation's treasure. But as we examine the reform provisions we continue to ask whether the reform solutions are good for the American public. Before turning to specific issues in H.R. 22, in general terms NNA seeks the following:

- ✓ A level playing field so that the USPS is not in the role of picking winners and losers among mailers.
- ✓ Adequate oversight: NNA is not desirous of overregulation, but of protection from a \$60 billion government agency thirsting for new products and volume—we need an avenue of recourse by an independent authority and strong oversight by Congress to ensure continued dedication to universal service by the Postal Service.
- ✓ Adequate public participation and public notice: to ensure fairness, we do not seek post facto solutions where the Postal Rate Commission would be cast in a “gotcha” role, but rather, an open process to enable all customers to participate.
- ✓ A system that ensures mailers are rewarded for preparing mail efficiently through discounts based on costs avoided by the Postal Service.

When NNA testified before this Subcommittee in 1996, we expressed concern over the basic premise that greater volume for the USPS will enable it to survive to provide universal service to everyone everywhere. This seems to continue to be the main solution underlying many of the reforms sought by the USPS and other volume rich customers. The underlying assumption is that more volume will generate more revenues that will allow the Postal Service to continue to operate without regard to long-run costs that probably would not be absorbed by the high volume mailers. Such a premise underlies the desire for volume-based discounts, pricing flexibility benefiting the volume rich, and secret contracts that would be based on the best arrangement between the contractor and the Postal Service. The winners will be large volume mailers, while the losers will be small volume mailers such as newspapers.

We believe that the USPS is best serving the public when it delivers the mail that exists rather than focusing on generating more mail volume. Its operating costs should be governed accordingly, expanding or contracting with the mail. Unfortunately, in the current environment, volume loss does not necessarily equate to cost reduction, as the rising costs for Periodicals mail show. We also wish to underscore that it is not good policy to ask the mail delivery agent to not only deliver the mail, but to generate more mail and craft new products rather than serving as a passive carrier of products and services. It would then be possible that the Postal Service would determine that it need not deliver products of its competitors. Or, if the law required it to operate as a common carrier, it would simply provide slower or less dependable service. It would then be more likely that the Postal Service will favor its own products and services when it structures its competitive offerings. Postal employees could be required to deliver the products and

engage in service offerings of the USPS's private law corporation rather than serving the delivery needs of the local community. Without appropriate structural separations and a Chinese wall erected in the database, the Postal Service would also have an insider's view of competitor's mailing patterns and their targeted reach to certain coveted segments of the marketplace. What would prevent the Postal Service, for example, from making a better offer to Safeway for advertising distribution once it detected a new Safeway ad in the local newspaper? Ultimately, the free marketplace would be skewed by the participation of a federal agency in private ventures.

SPECIFIC CONCERNS WITH H.R. 22

We believe that H.R. 22 in its current form contains many of the essential checks and balances necessary if we were to trade the existing cost of service regulatory scheme for a new, uncharted price cap regulatory scheme. Our main concerns with the legislation and the Postal Service's proposal are outlined below:

Price Cap Regulation:

Under today's rate-setting procedures, the United States Postal Service submits an omnibus rate request before the Postal Rate Commission approximately once every three years. The Postal Rate Commission conducts a ten-month regulatory hearing—a short time period in which to decide appropriate rates for the diverse mailing community. Newspapers are part of the Periodicals mail class. Our members pay the regular Periodical rate for newspapers travelling outside of their local counties. Most small newspapers also qualify for the within county rate, which includes the attributable cost for our mail subclass plus a contribution to the Postal Service's overhead. Within county mailers pay one half of the mark up of the most closely corresponding commercial rate,

which is in this case, the Periodicals rate. (See 39 U.S.C. Section 3626.) Within county mailers must be entered within the county of the local post office in which the mail is entered for delivery to addresses within that county. Such newspapers must have a total paid circulation of less than 10,000 or the number of paid copies of such issue distributed within the county is more than 50% of the total paid circulation of such issue. (39 U.S.C. 3626 (g)(1-2))

Existing law provides for consideration by the Postal Rate Commission of important factors of the educational, cultural, scientific and informational value to the mail recipient, among others. (See 39 U.S.C. Section 3622)

Newspapers perform extensive and time-consuming work-sharing in order to lower their overall postal rate bill. This may include drop shipping their newspapers so that the mail moves farther into the mail stream and saves the USPS added costs, a practice for which they presently receive no discount unless they comply with complex “additional entry” regulations. The newspaper publisher may also be performing mail sortations so that the newspaper is sorted for the postal carrier route. Many also attempt to sort their mail according to the postal carrier's walking pattern or line of travel—another contribution for which some are denied a discount for not meeting a certain number of mail pieces. This also will lower the overall postal bill for the newspaper. Performing these functions saves the publisher and the Postal Service hundreds, even thousands of dollars in postal costs. Over decades of rate case proceedings, these work-sharing discounts have been shown to be beneficial to the Postal Service and to the economy as a whole.

Under the new system in H.R. 22, a price cap would be applied for the non-competitive mail based on the consumer price index minus an adjustment factor on an annual basis. Rather than an omnibus rate proceeding, the Postal Service will apply the cap. (Sections 3731, 3732, 3733.) The strengthened Postal Regulatory Commission would establish the adjustment factor once every five years in an open proceeding (Section 3733.)

Numerous economists testified before this Subcommittee in April, 1997 that the price cap regime was crafted for the circumstances of a privately-owned, profit seeking firm that is regulated to prevent the exercise of market dominance rather than a federal agency operating the largest labor force in the public sector.

Under the price cap setting regime, we cannot answer whether work sharing would occur that would give the Postal Service the incentive to pass on its cost savings to customers. The price caps would be imposed on the non-competitive postal "products." Yet the price cap provides flexibility for the Postal Service to save up a rate hike by maintaining lower than authorized rates for a time—possibly to seize market share from a new private carrier—and then to suddenly raise them significantly once the private carrier was out of the market.

We also remain concerned that the cap would allow the USPS to engage in favored pricing beneath the cap. The ability granted to the Postal Service to "bank" unused pricing discretion adds to our concerns.

We do agree, however, that under the current system, there is little incentive for the United States Postal Service to control its costs because all of its costs are ultimately passed on to the consumer, regardless of how efficiently or inefficiently the Postal

Service operates. Periodicals customers face the consequences of such inefficiencies in higher rates. But we are not convinced that the price cap system proposed would effectively shield our newspapers from discriminatory treatment, or that it has been established whether work-sharing by mailers would continue to be an important factor to offset rate increases.

Negotiated Service Agreements:

Under Section 202 in H.R. 22, in addition to price cap regulation for non-competitive services, the Postal Service would also be able to negotiate private deals with its customers, assuming the deal will ensure the Postal Service will be better off. Such an evaluation is often in the eye of the beholder. The Postal Service could argue such a private arrangement benefits all mail customers because it allows the Postal Service to retain market share and its largest customers, rather than passing on cost savings to its other customers. We are not yet comfortable with the concept of negotiated service agreements, but do appreciate the advance review by the Postal Regulatory Commission as provided by H.R. 22, rather than the secret tariff arrangement advocated by the Postal Service in its amendments. Additionally, under the Postal Service's proposal, publishers and other mailers would only be able to file a complaint after the contract has been in place. The provisions of the deal would remain confidential.

Such agreements are not meaningful to America's community newspapers. It is not within the realm of reality that a small, rural newspaper customer would provide the benefits the Postal Service would seek in such arrangements, nor is it possible that our newspapers would have the time to go before the PRC in an advance review proceeding in Washington, D.C.

There is a danger that such special deals would result in a two-tiered postal system—where one set of select postal patrons would receive the best treatment, while other users would receive poor treatment and higher rates because they could not offer the same enticements to the Postal Service. These postal have-nots would be faced with only one avenue of recourse—the PRC, but would have few tools to fight the deals since the arrangement would be secret.

It is not adequately developed why such special deals are in the public interest. There is a greater likelihood that universal service would be damaged by allowing the agency to focus on a select group of customers. There is only one national postal system that exists to serve all customers. It is unclear what new operations would have to be put into place to serve select customers by the Postal Service. It is more beneficial to the system as a whole if available discounts were passed to all customers based on open, objective criteria under the review of the Postal Regulatory Commission. We do not support negotiated contracts and urge their rejection.

Rates For Products in the Competitive Category:

H.R. 22 separates the rate-setting provisions between the non-competitive and competitive categories of mail. Non-competitive mail would include the classes used by newspapers, namely, Periodicals mail and Standard A for their advertising mail and shoppers. These mail classes would be subject to the price cap regime. A second category would be “competitive mail,” including Priority mail, expedited mail, mailgrams and parcel post. Rates in this category are established by the Board of Directors of the Postal Service. The product must cover its attributable costs and the entire category of mail must

collectively provide an equal cost contribution as is applied by non-competitive mail. This category will also be subject to the same laws faced by private industry.

We support this provision so long as there is a strong firewall established between the competitive and non-competitive products. Our concerns with this division, however, is that there is a danger that the captive mail could cross-subsidize competitive mail if the amendments offered by the Postal Service are adopted, or that the Postal Service would use its monopoly powers to develop a purportedly non-competitive product and then catapult it over the wall where absence of regulatory control would permit monopoly profits. This has occurred in other industries where a project is rolled out by the regulated entity through its subsidiary and financed by its monopoly products. For example, in the early days of telecommunications reform, state public utility commissions routinely complained that their meager auditing staffs were wholly unable to detect the complex bookkeeping fiats that they believed enabled local loop telephone companies to shift costs to the monopoly so that the unfettered competitive subsidiaries could offer lower prices. It will be quite difficult to demonstrate that the competitive products will be able to cover attributable costs and can also “collectively” contribute to the overhead.

Meanwhile, the Postal Service has offered amendments that would eliminate the requirement that such products must make a contribution to the overhead of the USPS—clearly allowing for the possibility that the captive mailers will be paying for the successes and failures of such products in added overhead costs. Will the postmaster, for example, be working for the monopoly products exclusively, or will we pay his or her salary while the job drifts irredeemably to developing the competitive side of the Postal Service? We are also skeptical of the assertion by the USPS that it can separate its assets

and liabilities between competitive and non-competitive segments of the Postal Service. Will depreciated buildings, for example, be shifted cost free to the new corporation so that the monopoly ratepayers must pay the bill for new facilities? Or will the cost basis and depreciation be recaptured and passed on to the private law corporation in a sales price? Will the private law corporation pay taxes on the basis of its acquisition-priced assets or upon the basis of the Postal Service acquisition? Again, this may create a two-tiered postal system counterproductive to universal service where captive mailers are paying for new ventures by the Postal Service. We would urge the Subcommittee to reject these amendments.

Market Tests:

H.R. 22 offers the opportunity to the Postal Service to conduct two kinds of market tests. The first allows for a market test for "experimental noncompetitive products," which would be significantly different from all products offered by the Postal Service "within a two year period prior to the test." (Section 3751) Revenues received could not exceed \$10 million annually. There is an added test to be performed by the PRC to ensure the test does not cause "undue market disruption." The test could last up to two years. (Section 3751) There is a requirement that the Postal Service is to file with the Postal Regulatory Commission a notice setting out the basis for the test 30 days before initiation. (Section 3751 (c))

The second type of test would occur for experimental competitive products. This test would be for products substantially different than all other products offered by the USPS in the two-year period preceding the test. The test cannot exceed \$100 million annually in revenues. It would be limited to two years. The PRC would again regulate

these tests to ensure against “unfair or disruptive competition.” There is also a notice provision requiring the Postal Service to provide notice to the Postal Regulatory Commission that the test meets the requirements of the law. (3752 (c))

NNA is concerned with the size of these tests and their impact on private industry already offering many of the products the Postal Service would seek to offer. To the Postal Service, as reflected in its proposed amendments to H.R. 22, the size of the tests are not enough. To a small mailer already subject to competition in the free marketplace, such tests would be enormous.

We fear that these tests will focus the Postal Service on competitive ventures while losing sight of its core universal service delivery mission. We question where funding for such large tests would be derived. If there is to be such a large test, will non-competitive services need to pay for the start-up costs? There is also no direction as to what the excess revenues from market tests are used for, whether more tests or whether to lower mail rates for the customer. Finally, we question whether the jurisdiction of the Postal Regulatory Commission is being extended into the antitrust arena to examine the impact of these test on the marketplace.

Private Law Corporation:

H.R. 22 also would give the Postal Service the opportunity to set up its own “private” corporation. (Section 204) The Postal Board of Directors could establish this company and take all steps necessary for incorporation. It is specified in the bill that neither the entity is not to be considered an instrumentality of the United States nor a government controlled entity. Meanwhile, the Postal Board would choose the Board of

Directors of the company—which begs the question of the corporation's independence from the USPS.

The company would be able to issue stock but the shares must be purchased by the "Postal Service Competitive Products Fund." This fund is set up by the Postal Service to offset its costs in providing competitive services. (Section 203) The corporation could offer any postal or non-postal products with the exception of the postal monopoly. It would also engage in joint ventures and other alliances with private industry.

Unfortunately, the provision in the legislation as well as the proposals offered by the Postal Service itself fail to even to support the concept of promoting universal service through funds from this private corporation. Both H.R. 22 and the Postal Service seem to accept the premise that the Postal Service is no longer a relevant agency in today's society and should therefore be backstopped by a private company. We are concerned that in offering postal products, this new corporation could erect a new postal system operating on a parallel track with the existing Postal Service, only funded by its competitive products. The private corporation will gradually skim the cream, and quietly retire the public service obligation from the traditional Postal Service as being too costly.

In offering non-postal products, this new corporation could compete effectively with private industry. NNA does not support the concept that the federal government should be unleashed by Congress to compete with private business, even if the intent of the competition is to further universal service. Meanwhile, nothing compels the private corporation to fund universal service. We do not believe it serves the public interest to allow the Postal Service to engage in nonpostal activities where its economies will distort

the private marketplace. We are not convinced such a trade-off would serve the nation in maintaining a strong and healthy Postal Service.

CONCLUSION

Despite our objections to some of the provisions of H.R. 22, we understand that postal reform is an evolving work in progress. The Subcommittee staff has been outstanding in providing clarification and guidance. The staff of the Postal Service, under the leadership of Postmaster Henderson has been open and involved in mailers' needs and interest in postal reform. We appreciate the opportunity to share our views and look forward to working towards an acceptable postal reform bill that will be beneficial to our members and to the communities they serve.

TESTIMONY OF

MICHAEL DZVONIK

CHAIRMAN, MAIL ADVERTISING SERVICE ASSOCIATION INTERNATIONAL

BEFORE THE

SUBCOMMITTEE ON THE POSTAL SERVICE
COMMITTEE ON GOVERNMENTAL REFORM AND OVERSIGHT
U.S. HOUSE OF REPRESENTATIVES

MARCH 4, 1999

On behalf of the Mail Advertising Service Association International (MASA), I would like to thank the Chairman for this opportunity to comment on H.R. 22, the Postal Modernization Act of 1999. I am the Chairman of the Board of Directors of MASA and Chairman and CEO of Grizzard Advertising, a direct marketing and fund raising firm headquartered in Atlanta, Georgia. Our company has about 650 employees in our production facilities in Atlanta and Houston and in agencies and sales offices elsewhere around the country.

MASA is the trade association for the mailing services industry. It has about 680 member companies nationwide, comprised of lettershops, data processing companies, mailhouses, direct mail agencies, fulfillment operations, and suppliers to these businesses. We are a very significant "partner" of the Postal Service, performing mail preparation services for what has been estimated to be half of the Standard Mail (A)

advertising mail handled by the Postal Service. We also process a large volume of First Class mail. Our role is to prepare the mail that our "partner" the Postal Service delivers.

As the Committee is aware, MASA has provided testimony before on the predecessors to H.R. 22. My predecessor as Chairman of MASA, Dan Goodkind, testified in support of H.R. 3717, and offered suggestions for modifications to that bill that, in the association's view, would help implement the objectives of postal reform. Many of these suggestions were addressed in the original version of H.R. 22, and we are grateful that our voice was heard. We offered additional comments on the original version of H.R. 22. In general, we were supportive of postal reform as reflected in H.R. 22. We expressed concerns about the details of some of the pricing, ratemaking and regulatory reforms in the bill. To some extent these concerns have been addressed. MASA continues to be in favor of postal reform. MASA also continues to support the regulatory reforms in H.R. 22, specifically including the flexibility that H.R. 22 would afford the Postal Service in pricing competitive and non-competitive products and proposing new and experimental services. We also support special negotiated service agreements for the competitive products, but not for the non-competitive monopoly products if piece volume is one of the price determinants.

But the one paramount feature of H.R. 22 that MASA members, as small businesses that depend upon and work in close partnership with the Postal Service, cannot under any circumstances support, is the provision for a private law corporation. This corporation would be wholly owned by the Postal Service, financed by Postal Service revenues, and permitted to compete in any area – postal or non-postal – without constraint on its activity. In short, if the private law corporation were to become a reality, each and every MASA member would be at risk that the Postal Service would decide to move up the supply chain and enter into competition directly with those businesses that now supply it with so much of the advertising mail it delivers. Despite MASA's earlier objections to this provision when it first appeared, it remains a central feature of the bill.

I cannot emphasize enough how strongly MASA objects to the private law corporation, on both philosophical and practical grounds.

We see no possible philosophical justification for creating a government backed corporation to compete with private business. While the Postal Service is clearly facing many pressures on its core business from electronic diversion and other sources, the remedy is not that government should go into business to compete with the private sector for profits. There is no precedent for the unparalleled scope the private law corporation would be afforded. Other government sponsored enterprises, upon which the bill's provisions are apparently modeled, are limited to activities that are within the basic mandate of their charter. For example, Fannie Mae is chartered to foster home ownership by facilitating residential mortgage financing, and it engages in activities incident to this charter. And yet, even within its relatively focused charter, its participation in a market already served by many other private corporations has proved controversial, as private securities firms have complained vigorously that Fannie Mae enjoys an unfair competitive advantage in the mortgage backed securities markets. Under H.R. 22, there is no such focus – the private law corporation lacks even the justification that it is to advance a particular governmental policy. Its only justification is that if it can successfully earn profits at the expense of its private competition it will reduce the costs of providing mail services by the Postal Service. It is impossible to conceive that the American public or business in general would support the concept that government should go into competition with private business in order to reduce the cost of providing essential governmental services.

The Congress has recently expressed its view on government being engaged in clearly non-governmental activities by passing S. 314, the Federal Activities Inventory Reform Act (FAIR Act). While the FAIR Act is designed to ensure that government agencies restrict themselves to reasonable "government" activities, HR22's private law corporation provision would authorize the Postal Service to go into any business it desires, including,

ludicrously, the opening of Buick dealerships around the country.

The great irony of the private law corporation, moreover, is that it does not even accomplish its stated objective. Under H.R. 22, the private law corporation is financed by the Competitive Products Fund, that is, from Postal Service funds that would otherwise support core postal services, either competitive or non-competitive. Assuming it earns profits, and does not simply lose the Postal Service investment through unprofitable operations, there is no requirement that such profits benefit the Postal Service core function – delivery of the mail. If the private law corporation simply plows its profits back into building its competitive business, the Postal Service will not see one dime of benefit from the private law corporation. All that would occur is an asset, in the form of stock ownership in the private law corporation, on the books of the Postal Service. There is, frankly, no particularly easy way to fix this problem consistent with the basic objective of growing the private law corporation's activities. Normally a growth company would want to use revenues and profits to build its business. Requiring it to pay dividends, for example through some cumulative preferred dividend feature, would only put a brake on the growth contemplated by the private law corporation in the first place. Clever accounting or financing vehicles could probably circumvent any such provision, in any event.

The fundamental problem with the private law corporation for MASA's members, however, is that it would put our members in competition with their Postal Service "partner." Our members work with the Postal Service every day to make the mailstream more efficient and to make mail a more attractive advertising product for our customers. Our businesses are not only dependent on the Postal Service, we are a true partner in the sense that both our businesses and the Postal Service have the same interest in improving postal products and services and growing the volume of mail. Indeed, advertising mail is the fastest growing part of the mailstream. Through the private law corporation, however, it would be entirely possible that the Postal Service would, as one person has put it, try to

go up the "value chain" by expanding its operations vertically into the business areas that provide mail to the Postal Service for delivery. If the private law corporation, using the resources it obtains from Postal Service funding, enters the business of providing list maintenance, sortation, printing, stuffing, mail preparation, and the like, our MASA members would face competition from their most important partner, a partner upon whom they are absolutely dependent.

MASA simply does not believe that this is either fair or good policy. Small businesses throughout the country would undoubtedly be appalled if they knew that Congress was contemplating a government sponsored competitor such as the private law corporation.

MASA very much appreciates and supports the diligent and hard work by the Chairman and the Committee to come up with a bill that contains so much that is positive and necessary in postal reform. If the regulatory provisions of H.R.22 are passed, great progress will have been made to enable the Postal Service to continue as a healthy enterprise providing the fundamental mail delivery service that is its central mandate. We urge that the Committee reconsider the private law corporation and excise it from H.R. 22.

Subcommittee on the Postal Service
Committee on Government Reform
U. S. House of Representatives

Statement of
William B. Disbrow
President and CEO
Cox Target Media, Inc.
8605 Largo Lakes Drive
Largo, Florida 33773-4910

With respect to
H.R. 22
"The Postal Modernization Act of 1999"

March 4, 1999

Mr. Chairman, thank you for the opportunity to present you and the other members of the Subcommittee with the comments of Cox Target Media, Inc. with respect to H.R. 22, the Postal Modernization Act of 1999.

Val-Pak Direct Marketing Systems, Inc. and Carol Wright

Cox Target Media, Inc. has two wholly-owned subsidiaries which are substantial mailers, primarily using Standard A Mail. Val-Pak Direct Marketing Systems, Inc. is the nation's largest firm in the subset of the hard-copy, direct mail cooperative advertising industry which is sometimes referred to as "coupons in an envelope." Val-Pak operates in all 50 states through approximately 210 U.S. franchises which are members of the Val-Pak Dealers' Association, Inc. The work of these franchisees is supplemented by efforts of approximately 1,200 sales representatives. Cox Direct, trading as Carol Wright, is one of the largest firms in this same market segment. Both companies' headquarters are located in Largo, Florida. Val-Pak also prints at and mails from a large facility in Las Vegas, Nevada for 11 western states. Carol Wright also operates two plants, located in Elm City, North Carolina and in Washington, North Carolina. Val-Pak and Carol Wright collectively mail over 800 million pieces annually.

Val-Pak, joined recently by Cox Direct, has been an active intervenor before the Postal Rate Commission in recent dockets, including the major reclassification case, Docket No. R95-1, the most recent omnibus rate case, Docket No. R97-1, as

well as a variety of other matters. In the last rate case, we were quite pleased that the Postal Service finally elected to request a modest increase, instead of waiting until operating deficits piled up to the point where a major hike in rates became necessary. This change in policy by the Governors addresses one of our prior criticisms of the Postal Service's approach to rate-setting.

It must be understood that our two businesses are enormously reliant on the United States Postal Service. We earnestly and enthusiastically support the Postal Service in its carrying out its basic mission — to deliver the mail, rapidly and economically. We need and want the Postal Service's delivery business to thrive and prosper in coming years. It is for this very reason that we have been willing to make constructive criticisms when we felt it necessary. As will be discussed later, Val-Pak was an early critic of the Postal Service's inadequate research and development (R&D) and capital investment plans, and a proponent of the Postal Service's shifting to a policy of making massive investment in its own infrastructure. It is for this reason that we are most appreciative of the time that you and your Subcommittee have invested in the current effort to investigate changes in legislation which may be necessary to assist the Postal Service to modernize so that it can better face a variety of marketing and operational challenges.

As I will explain in more detail below, we agree fully that the Postal Service desperately needs to expand and modernize its infrastructure at a much faster rate, become more efficient, increase productivity, reduce costs and improve the service given to all classes of mail, especially Standard A Mail. Nevertheless, we appear to view the realities of modernization in terms that may be somewhat different and, perhaps, broader than that of the Postal Service, or that covered by H.R. 22 in its current form. In fact, we have serious reservations about certain portions of H.R. 22 as well as reservations about certain of the extensive amendments which the Postal Service has proposed. It is also our view that certain issues essential to the future success of the Postal Service are not being adequately addressed either by the Postal Service or by H.R. 22.

Postal Service Infrastructure

In order to handle the vast volumes of mail that are generated each business day, the Postal Service has an extensive network of facilities and equipment through which the mail must move. Collectively, this network and those facilities form the infrastructure that constitutes the backbone of the Postal Service. In a competitive world no infrastructure can remain functional without a process of constant maintenance and improvement. This is especially true when the technology that undergirds the infrastructure is undergoing rapid evolution. The health and vitality of this infrastructure are infinitely more important than whether the rate setting process established in the Postal Reorganization Act of

1970 is to be tinkered with. The generally agreed-upon goal is for the Postal Service to achieve lower rates and better service, which will benefit all mailers and also make the Postal Service more competitive. The problem is not in the nuances of pricing under the Postal Reorganization Act, which has worked admirably well for over 25 years. It is our view that the principal problem faced today by the Postal Service is the Postal Service's own unwillingness to invest in itself and its core mission as it needs to do. The solution to this problem can be achieved by the Postal Service acting alone, without a single legislative change.

Since the Postal Reorganization Act became effective, the Postal Service has enjoyed a remarkable growth in mail volume. From 1978 to 1998, total volume more than doubled, from 96 to 198 billion pieces. Too many of our existing postal facilities were not built to handle today's volume, much less any future increases in volume. Considering the cramped and over-crowded condition in which many postal employees must work, they do an admirable job of getting the mail delivered. We often marvel at how well they do under such adverse circumstances. However, because the Postal Service has struggled so long with an infrastructure that has been inadequate for the growing volume of mail, it may have become complacent about the fact that it perennially has so many undersized and cramped facilities. We urge you to consider whether this infrastructure is being properly tended to before legislative changes are finalized, for it is the infrastructure that will determine whether the Postal Service will be successful into the next century.

Inadequate Spending on Capital Investment by the Postal Service

The amount of money invested by the Postal Service over the last decade, along with its operating revenues, is summarized in Table 1. As shown in column 1, operating revenues have grown each year, from approximately \$40 billion in 1990 to \$60 billion in 1998. Net investment, however, shown in column 4, is another story. Beginning in 1993, net investment declined precipitously as the Postal Service's automation program virtually ground to a halt for several years. Even after recovering a bit, the \$1.56 billion of net investment in 1997 was still less than the \$1.69 billion of net investment in 1992, not even considering the inflation creep and volume increases over the intervening years.

Column 5 of Table 1 helps put the Postal Service's net investment spending into better perspective. It shows net investment as a percentage of the Postal Service's operating revenues. Between 1990 and 1992, the percent of operating revenues spent on net investment grew from 3.0 to 3.7 percent, then dropped to as little as 1.2 percent. With respect to investment spending, the Postal Service appears to have been "ramping down" during a time when it should have been "ramping up." We would urge that net investment be ramped up to at least 3.7 percent of operating revenues, the level reached in 1992.

The level of the Postal Service's long-term debt is also revealing as an indicator of the Postal Service's ability to have undertaken net investment

spending. The Postal Service's long-term debt is summarized in Table 2. As you can readily observe, since 1992, the Postal Service's outstanding long-term debt has declined sharply, from \$9.2 to \$2.8 billion. This reduction in debt may have strengthened the financial balance sheet. However, it was obtained, at least in part, as a result of the meager level of net investment by the Postal Service, and the concomitant failure of the infrastructure to keep up with the growth in volume.

Had the Postal Service been modernizing aggressively during the last six years, it would have been unable to pay down its long-term debt as rapidly as it did. The long-term debt level certainly would not have declined by 70 percent; more likely it would have declined less, perhaps stabilized or, under an aggressive investment strategy, it could even have increased (although we are not necessarily saying that such a high level of investment should have been undertaken). Under an aggressive investment plan, the statutory debt limits contained in 39 U.S.C. Section 2005 might have needed this Subcommittee's review, since those restrictions on borrowing were set when the Postal Service was a substantially smaller enterprise than it is today, and before automation became a feasible avenue for profitable investment.

The six-year decline in investment spending represents a missed opportunity to modernize. Opportunities like this are difficult, if not impossible, to recapture. One result of these years of investment neglect is the emergence of too many

cramped and overcrowded postal facilities, which, we believe, have contributed mightily to the inconsistent quality of service received by Standard A Mail.

In Chairman McHugh's prepared comments delivered at the hearing on February 11, 1999, he noted that former Postmaster General Runyon's call for reform of the current regulatory system some four years ago was perhaps the most important factor starting the Subcommittee on its current journey. On more than one occasion we have wondered whether the current legislative drive to change the way rates are set inadvertently may have diverted attention from the critical issue of why the Postal Service was cutting back on its automation program and doing so little to expand and modernize its infrastructure.

Inadequate Spending on Research and Development by the Postal Service

Another critical area that has been neglected woefully by the Postal Service is R&D. Spending on R&D is like seed corn. It is a vital investment in the future, because it creates opportunities for productive ways to invest capital. When directed properly, R&D spending can be among the wisest investments of all.

Postal Service spending on R&D since 1990 is shown in Table 3. As can be easily seen, again starting in 1993, R&D expenditures were curtailed sharply, and since that time they have remained at a comparatively low level. To us, this reduction in R&D seems extremely short-sighted for an organization that generates

over \$60 billion in revenues, has over 800,000 employees, and must move increasingly large mountains of mail each year. Unless the necessary R&D takes place today, it is somewhat unrealistic to expect the appearance of opportunities for investment in modernization tomorrow.

We believe that this Subcommittee should look at both R&D and capital investment levels. We would urge the Subcommittee, in its oversight capacity, first to investigate why the Postal Service is not increasing its investment and R&D efforts and, second, to examine whether the incentives contained in H.R. 22 are sufficient to get investment and R&D back on the track. Surely these matters are not the fault of the rate-setting mechanism which has received much unjustified criticism, as the Postal Rate Commission has no jurisdiction over expenditures for R&D or capital investment.

Modernization of Postal Service Facilities and Equipment

Modernization of the Postal Service infrastructure requires that relatively less efficient labor-intensive facilities be replaced with relatively more efficient capital-intensive facilities. So long as R&D and capital investment continue at inadequate levels, however, the Postal Service inevitably will continue being a labor-intensive organization.

When it comes to replacing labor with capital in postal operations, we recognize the time-honored principle of TANSTAFUL – “there ain’t no such thing as a free lunch.” It would be unrealistic to expect otherwise. To avoid the need to hire large numbers of new and expensive workers, a massive amount of capital spending is required. And catching up with investment spending that did not occur during the last six years will require time as well as money. To bring the Postal Service’s infrastructure fully up to rapidly evolving modern standards over the next 10 to 15 years, the required amount of new investment could exceed \$100 billion, a sum which dwarfs the amounts set out in the Postal Service’s Five-year Strategic Plan.

Val-Pak filed comments with the Board of Governors in July 1997 criticizing the level of capital investment planned for by the Postal Service, and urging far greater capital investment than that contained in the June 16, 1997, draft Postal Service’s Five-year Strategic Plan (FY 1998-2002). Subsequently, the Postal Service’s own Blue Ribbon Committee issued a report that also criticized the Postal Service’s level of investment spending as inadequate and urged higher levels. Not many voices were then urging increased capital investment.

The Postal Service certainly has its work cut out for it. Moreover, with the possible exception of the debt limit provision in the Postal Reorganization Act, it would appear that the Postal Service has the authority under existing legislation to do what needs to be done. Perhaps the incentive structure is what is lacking, and

perhaps the Postal Service needs more Governors who are familiar with running large organizations. We question, however, whether the incentives in H.R. 22 will provide the Postal Service with adequate motivation to correct these obvious and continuing problems. Certainly the bill's provision dealing with the experience required for Governors is a good idea, and perhaps the emoluments of Governors should be increased, in keeping with the qualifications sought in Section 212.

Retain the Productivity Factor in the Rate Cap Formula

Our concerns about investment provide the basis for our views on the productivity factor in the proposed rate cap formula in H.R. 22. As noted above, we do not regard annual net investment of under \$2 billion as sufficient for the Postal Service, as it can usefully put in place much more. Substantial investment, properly directed, should increase productivity markedly, and those gains in productivity should be shared with mailers through lower rates via the productivity factor. For Standard A mailers, the promise of higher productivity and lower rates is the chief enticement of the rate setting mechanism proposed in H.R. 22. Without this, the bill offers mailers such as us nothing but potential increased competition from the Postal Service. For this reason, we would strongly urge the Subcommittee to reject out of hand the Postal Service's proposed amendment concerning establishment of the adjustment factor, because it effectively would eliminate the productivity dividend by treating it normally as "zero." Indeed, in our view, H.R. 22 should be structured to give the Postal Service every conceivable incentive to

increase productivity. One such incentive would be for the Commission to set a high but attainable level for productivity increases.

Retain Equal Markup for Competitive and Monopoly Baskets

H.R. 22 makes a useful distinction between competitive and non-competitive products, and creates separate baskets for each. With respect to the basket of competitive products, the Postal Service may deserve more flexibility in the way it sets rates. However, that flexibility must not be allowed to relieve competitive products from paying a fair share of the Postal Service's institutional costs. Speaking as a customer totally captive to the Postal Service's monopoly, we are of the opinion that the Postal Service's proposed amendment concerning cost coverage of competitive products, which would sunset the equal markup provision after five years, should be rejected. Without this provision, mailers whose rates are in the non-competitive basket would stand a great risk of paying virtually all of the Postal Service's institutional costs.

Postal Service Competition with Private Sector Businesses

Hopefully, the preceding critique provides a useful backdrop for our views on how much and where the Postal Service should be allowed to compete with the private sector. As you can tell from these comments, we at Cox Target Media are strongly in favor of the Postal Service expanding and modernizing all of its facilities and carrying out its traditional mission to deliver the mail, efficiently and reliably.

In 1998, the Postal Service had to deliver over 12 million tons of mail — a formidable task indeed. To its credit, the job did get done. On too many occasions, however, delivery was inconsistent and not in conformity with the Postal Service's own standards. Better carrying out of its basic mission would, of course, make the Postal Service a strong competitor in the delivery service arena. A reliable delivery service for Standard A Mail that consistently met service standards 98 percent of the time would also help generate desirable growth in mail volume, perhaps sufficient to sustain the Postal Service well into the next century.

With respect to that basic mission, as an illustration of the problem, we point to the principal class of mail that we use — Standard A Mail. For over 20 years, the Postal Service has been promising to implement a system for measuring performance of Standard A (formerly third-class) Mail delivery. To date, however, the Postal Service is not able to track one single piece of Standard A Mail as it moves through the postal network. Too many mailers report that service is inconsistent, and in need of improvement. Consequently, first things being first, we are strongly of the opinion that the Postal Service should get its own house in order and invest all available resources in modernizing the postal network before it even contemplates any investment in other non-postal ventures that are designed to compete with or replace private ventures.

While the infrastructure issue is being ignored, we believe that attention is being mis-focused by some of the provisions set out in H.R. 22. It is our view that new investment by the Postal Service in competitive areas not directly related to modernization of postal facilities, as sought by the Postal Service, is not the solution to any problem reasonably faced by the Postal Service. Such investment in competitive areas would be able to provide a meaningful offset to the Postal Service's \$20 billion of institutional costs if and only if (i) the return on such investment is well in excess of the interest cost, and (ii) the return is sufficiently large to represent a material offset to the \$20 billion of institutional costs. Let us take an illustration to see if this is likely.

Assume that investment in competitive areas would earn an average gross return of 10 to 20 percent (even though the General Accounting Office reports seem to indicate that most Postal Service initiatives have failed to make any money at all), and interest would cost 5 to 6 percent. The Postal Service would need to invest many billions of dollars in order to effect a meaningful reduction in institutional costs that now exceed \$20 billion, and grow with each passing year. Such a multi-billion dollar investment program not only would divert much needed investment resources and management attention away from the postal infrastructure, which is necessary to carry out its core business successfully, but would also imply extensive competition with the private sector by a government-sponsored monopoly virtually

anywhere in the economy the Postal Services feels it might have a competitive advantage that it could exploit to earn additional net revenues.

To better understand what the Postal Service could also do with the increased ability to compete with the private sector, some recent history is instructive. Only a few years ago, the Postal Service attempted to move into one area where it would have been in direct competition with Val-Pak, in developing a new product which it called Neighborhood Mail. Under this proposal the Postal Service would have accepted unaddressed circulars from small advertisers for delivery as so-called "third-bundles." Although Postal Service management eventually saw the unworkability of this proposal, it took significant mailer efforts to get this point across.

The Postal Service's recent move into the direct mail advertising business by selling "coupon" type advertising to businesses as part of its new mover mailings is another illustration demonstrating the Postal Service's continued willingness to compete directly with the private sector. H.R. 22 provides no guarantee whatsoever that Neighborhood Mail, other forms of coupons, or similar bad ideas would be discouraged from being pursued. More likely it would actually encourage the Postal Service to devise new ways to compete with its customers in an effort to extract additional net revenues from the mail wherever it saw the opportunity. The provision for a private law corporation is fraught with potential problems, and we

would ask the Subcommittee to reconsider whether it wants to open that Pandora's Box at this time.

Lastly, while this bill allows the Postal Service increased opportunities to compete freely, H.R. 22 offers the Standard A Mail customer no benefits of competition, and no relief from the monopoly. If competition is desirable for the Postal Service as a business, and the Postal Service wants to be free to become a competitor with private firms, there is no justification for the Postal Service to insist that it retain all of its governmental privileges and maintain a statutory monopoly over the mail of businesses and individuals who send so-called "letter mail." We have serious philosophical problems with unfettered competition by a government-sponsored monopoly, as other, better ways to retain universal service exist.

In light of the preceding considerations, we strongly recommend that the Postal Service's ability to invest in non-postal areas not be expanded at this time. The issue of diversification and unfettered competition with the private sector can be revisited after the Postal Service puts its own house in order with respect to its core function of efficient and economical delivery of the mail.

Table 1

U. S. POSTAL SERVICE
OPERATING REVENUES AND INVESTMENT
1990 -- 1998

	(1)	(2)	(3)	(4)	(5)
		Gross			
		Investment:			
		Purchase of	Depreciation	NET	Net
		Property &	and	INVEST-	Investment
		Equipment	Amortization	MENT	as Percent of
Fiscal	Operating	(mill)	(mill)	(mill)	Operating
Year	Revenues				Revenues
----	-----	-----	-----	-----	-----
1990	39,655	1,858	669	1,189	3.0%
1991	43,884	2,321	734	1,587	3.6%
1992	46,151	2,475	784	1,691	3.7%
1993	47,418	1,885	889	996	2.1%
1994	49,383	1,727	992	735	1.5%
1995	54,293	1,808	1,141	667	1.2%
1996	56,402	2,340	1,333	1,007	1.8%
1997	58,216	3,233	1,673	1,560	2.7%
1998	60,072	3,055	1,579	1,476	2.5%

Source: Annual Reports of the U. S. Postal Service

Table 2

U. S. POSTAL SERVICE
LONG-TERM DEBT
1990 -- 1998

Fiscal Year	Long-term Debt at end of Fiscal Year (millions)
-----	-----
1990	6,668
1991	8,139
1992	9,173
1993	8,686
1994	7,727
1995	7,019
1996	3,909
1997	3,225
1998	2,788

Source: 1998 Annual Report of the
U. S. Postal Service,
pp. 72-73.

Table 3

U. S. POSTAL SERVICE
RESEARCH & DEVELOPMENT EXPENDITURES
1990 -- 1998

Fiscal Year	Research & Development Expenditures (millions)
-----	-----
1990	81
1991	115
1992	168
1993	58
1994	50
1995	52
1996	56
1997	68
1998	77

Source: Annual Reports of the
U. S. Postal Service,
Auditor's Note 2.



U.S. Department of
Transportation
Office of the Secretary
of Transportation

GENERAL COUNSEL

RECEIVED
800 Seventh St., S.W.
Washington, D.C. 20590

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February 22, 1999

The Honorable John M. McHugh
Chairman, Subcommittee on the Postal Service
Committee on Government Reform
and Oversight
U.S. House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

This letter responds to your request for the Administration's views on the Postal Modernization Act of 1997 (H.R. 22 in the 105th Congress) and, in particular, the provision of the bill (section 502) that would allow the United States Postal Service (USPS) to contract for the carriage of international mail.

To provide you with the most up-to-date information on the Administration's position, I have enclosed a provision (section 707) from the Department of Transportation's February 8, 1999, Federal Aviation Administration Authorization that addresses the issue of international mail rate-setting authority. Section 707 provides for termination, as of October 1, 2000, of the Department's international mail-rate-setting authority. Assuming enactment in this session, this provision would allow the USPS and U.S. carriers a sufficient period of time to negotiate a new basis for the carriage of international mail.

The Department looks forward to working with the Committee on this important postal issue.

The Office of Management and Budget advises that, from the standpoint of the Administration, there is no objection to the submission of this report for the consideration of Congress.

Sincerely,

Nancy E. McFadden

SEC. 707. REPEAL OF MAIL RATE-SETTING AUTHORITY.

(a) Effective December 31, 1998, section 4(k) of the Act of July 5, 1994 (Public Law 103-272, 108 Stat. 1370), as amended by section 7(a)(3)(D) of the Act of October 31, 1994 (Public Law 103-429, 108 Stat. 4329), is repealed.

(b) Section 41901(a) is amended to read as follows:

"(a) TITLE 39--The United States Postal Service may provide for the transportation of mail by aircraft in air transportation under this chapter and under chapter 54 of title 39."

(c) In section 41902(b)--

(1) strike clause (1);

(2) redesignate clauses (2), (3), and (4) as clauses (1), (2), and (3), respectively; and

(3) in clause (2), as redesignated, strike "clauses (1) and (2)" and substitute "clause (1)".

(d) Section 41907(b) is repealed.

(e) Sections 41107, 41901(b), 41902(a), 41903(a), and 41903(b) are amended by striking "in foreign air transportation or".

(e) Effective date.--The amendments made by subsections (b)-(e) of this section take effect October 1, 2000.



Willmar Associates International, Inc.

Marketing Consultants
ROBERT C. WILLIAMSON, President

February 19, 1999

Honorable John M. McHugh, Chairman
Subcommittee on the Postal Service
Committee on Government Reform and Oversight
U. S. House of Representatives
2157 Rayburn House Office Building
Washington, DC 20515-6143

Dear Mr. Chairman:

We sincerely thank you and your committee for the opportunity to again review H.R.22, The Postal Modernization Act of 1999. Our testimony was prepared with the assistance from Mr. Ralf Seiffe, CEO, MAIL SORT-CHICAGO who has appeared before your committee in the past.

Our comments last Fall focused on:

- a. Misuse of the pricing authority granted by the Act which places the Postal Service in the position of "competing" on other than a level playing field since they set rates for expedited mail services by the private sector at higher than the Postal Service charges. The question then arises is this fair "competition" or is it a conflict of interest?
- b. We are still worried that the Act proposes significant liberalization of the ratemaking process in the monopoly baskets without offering the protections mailers have come to rely upon for setting equitable worksharing postage rates. It is our belief that left to its own counsel, the Postal Service will set rates to ostensibly meet the Act's targets for the very visible First Class stamp price but tinker with the worksharing rates to collect undeserved revenues.

Under the Act's proposals, we understand that the USPS will be free to set rates that meet outside, objective targets. We further understand that within any mail Class, the subsidiary rates can be adjusted at the USPS's whim. This new power must be assessed in the context of the USPS's other great power, that of regulation. Already, the USPS has nearly complete freedom to append regulations which apply to any rate category. Regulations have been used to shift USPS costs to the mailing industry and often without increases in the incentives. Experience in all rate cases since the late 1970s causes concern that the combination ratesetting and regulatory power, without the discipline of the Postal Rate Commission review, is a recipe for long-term disaster. In fact, it appears that regulations are used as a very effective tool to raise effective postal rates without outside review.

Specifically, we understand the USPS is committed to keeping the First Class "stamp" price under control. We are further worried that in meeting this objective, the USPS will set other First Class worksharing rates higher than they would otherwise be to essentially subsidize the single piece stamp rate.

2529 Regal River Road
Valrico, FL 33594

Ph: 813-684-4118
Fax: 813-681-5800

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 February 19, 1999

By making worksharing prices artificially higher, the USPS makes its most important customers targets of other, competitive media. If the volumes and revenues of these important customers is lost, the postal patrons remaining have a greater burden to bear and, in turn, become targets for diversion.

The current rate-setting system provides a forum for mailers to redress the proposals the USPS makes for all First Class, monopoly, rates. Over the years, the PRC has often valued worksharing's contribution differently than has the USPS. It is notable that in every rate case we can remember, save one, there has been a difference between the Postal Service's price proposals and the mailing industry's estimates of worksharing's value. Under the proposed Act, we do not see a venue for rationalizing these differences, setting economically efficient worksharing rates or for reviewing postage rates the USPS might set that industry finds unjustified.

It is our conclusion, therefore, that the rate setting mechanisms proposed in H.R. 22, as they relate to setting monopoly worksharing rates, do not meet the obvious goals of the legislation. To remedy this shortcoming, we propose that the relationship between the "stamp price" and the various subsidiary, worksharing rates be a part of the initial ratemaking process and that they be frozen proportionately and absolutely until the next rate setting process. Then, the USPS can use its regulatory powers, subject to normal rules making obligations of notice and review, to make small adjustments over the time between.

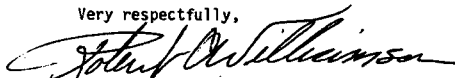
The Postmaster General, William Henderson, shocked leaders of postal unions and management associations by announcing on August 31, 1998 that the days of the Postal Service's 222 year-old monopoly are numbered. We concur with Mr. Henderson's view and vision that the termination of the First Class monopoly will help qualify the Postal Service's perceptions of "competition". Last November, Government Accounting Office (GAO) issued a sixty-one page study (GAO/GGD-99-15) titled, U.S. Postal Service: Development and Inventory of New Products. A brief summary of that study is quoted in part as follows: "The U.S. Postal Service has developed an array of new products in recent years, such as Global Priority Mail, prepaid phone cards and retail merchandise. Some Members of Congress contend that the Postal Service is unfairly expanding its product line to compete in non-postal markets and legislation to curtail such activity has been introduced. Some private sector companies have also raised concerns that the Postal Service could use its governmental status to an unfair advantage when introducing products that compete with private sector companies. This report(1) identifies the statutory and regulatory authorities and constraints covering all major groups of new products; (2) identifies the potential impact that H.R.22 and the Postal Service's proposed reform legislation could have on new products; and (3) discusses the Postal Service Marketing Department's new product development process." Accordingly, we recommend a revisit to the issue of the Postal Service's encroachment into the private sector's businesses through the overuse of the word "competition".

We support modernization of the Postal Service and commend you, your committee and staff for the outstanding job of preparing an Act which is very comprehensive and reflects the monumental effort to have legislation that will be fair to both the Postal Service and the private sector.

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Testimony for H.R. 22 Hearings
February 19, 1999

Subject to your approval and authorization, we request that this testimony be included in the record of your next hearing currently scheduled on March 4, 1999 at 2:00pm. We thank you for the opportunity to provide this brief testimony and offer our services whenever needed. Please do not hesitate to call us at 813-684-4118 if there are questions.

Very respectfully,



Robert C. Williamson
President

**Treasury Responses to Representative Fattah's Questions
Concerning H.R. 22, the "Postal Modernization Act of 1999"**

Question 1: Please list the benefits the postal service currently derives from having the full faith and credit of the U.S.

Answer: Although 39 U.S.C. Sec. 201 provides that the Postal Service is an independent establishment of the Executive Branch, nevertheless its obligations are not backed by the full faith and credit of the United States. At the Postal Service's request, however, the Secretary of the Treasury may grant full faith and credit guarantees to new Postal Service obligations if the Secretary determines that it is in the public interest to do so. There has been no such request.

While Postal Service obligations are not backed by the full faith and credit of the United States, if these obligations were to be financed in the market, as proposed by H.R. 22, they would be perceived by the market to have Government backing because the Postal Service is part of the Federal Government, serves a vital public mission, and enjoys a number of other statutory links and ties to the rest of the Federal Government, including:

- (1) The Postal Service is exempt from Federal income taxes;
- (2) The Postal Service may require the Secretary of the Treasury to purchase up to \$2 billion of its obligations;
- (3) At the Postal Service's request, the Secretary of the Treasury may grant full faith and credit guarantees to new Postal Service obligations;
- (4) Interest income on Postal Service obligations is exempt from State and local income taxes; and
- (5) Postal Service obligations receive special treatment for purposes of fiduciary investments or collateral for public deposits;

The Postal Service benefits from its ability to borrow from the Treasury. Under existing law, the Secretary of the Treasury has the right to purchase Postal Service obligations. Since the creation of the Federal Financing Bank (FFB) in 1973, the Secretary has exercised this right and has directed the FFB to finance such obligations.

If the Postal Service were to borrow in the private market, even though it has Executive Branch status, Treasury would expect it to pay interest at rates approximately 30 to 70 basis points higher than the rates on comparable Treasury securities, based on current market conditions. In addition, the Postal Service would be required to pay transaction costs that would be substantially higher than the 1/8th of 1 percent surcharge that the FFB charges to cover its

administrative expenses. Thus, Treasury believes that the Postal Service's ability to access the least expensive financing available provides a tremendous financial benefit to the Postal Service and its ratepayers.

Question 2: Is it possible for the competitive product fund to secure financing or interest rates lower than what is available with the Federal Financing Bank?

Answer: Treasury does not believe that the Postal Service could borrow in the market either on its own behalf or on that of the Competitive Products Fund (a Postal Service fund in the Treasury Department) at interest rates lower than the FFB's rates.

Question 3: Specifically, how should the firewall provisions contained in H.R. 22 be strengthened, changed, or structured?

Answer: H.R. 22 would establish a firewall between the Postal Service's noncompetitive and competitive postal products and operations by creating a new Competitive Products Fund in the Treasury and another firewall between its postal and non-postal products and operations by creating a new corporation (the USPS Corporation) to handle non-postal products and operations, which would be owned by the Competitive Products Fund. In Treasury's March 4, 1999 Statement on H.R.22, the Department articulated its position that both the proposed USPS Corporation, which Treasury views as an on-budget Federal agency, and the Postal Service, acting on behalf of the proposed Competitive Products Fund, should be required to borrow, bank and invest within the Treasury, just as other Federal entities are required to do.

Question 4: What is the impact on postal service financing, if the postal service does not have the backing of the federal government?

Answer: As a result of the perceived Government backing, Treasury would expect Postal Service obligations to be financed in the market at interest rates that would be approximately 30 to 70 basis points over the rates on comparable Treasury securities, based on current market conditions. While these market rates would be higher than the rates provided by the FFB, they would be considered preferential rates in comparison to the borrowing rates available to private entities. It is not clear how the perception of Government backing can be dispelled given the Postal Service's Governmental status and its special statutory ties and links to the rest of the Federal Government.



Mury Salls
President

Major Mailers Association

Jim Cole
Vice President

An Organization Of Quality First Class Mailers

John DePiazza
Chief Financial Officer

David Maloney
Secretary

February 25, 1999

The Honorable John M. McHugh
Chairman, Subcommittee on the Postal Service
U. S. House of Representatives
2157 Rayburn House Office Building
Washington D.C. 20515-6143

Mr. Chairman:

Thank you for your January 26, 1999 letter requesting our participation in the March 4, 1999 hearing on H.R. 22, The Postal Modernization Act of 1999. Unfortunately, because of a prior commitment, I will not be able to attend.

In lieu of my direct testimony, the following details the Major Mailers Association's (MMA) view on H.R. 22 for your consideration.

First, a little background on MMA. Our association is comprised of mailers who individually produce over one million first-class mail pieces a month, which are mainly statements and bills. Our association has been extremely active in partnering with the Postal Service on classification initiatives as well as new product identification and implementation. We have also taken a lead role at the Postal Rate Commission in arguing for fair rates for first-class mailers and have been very successful in that regard. To date, we have been monitoring H.R. 22 and now believe our understanding is such that our comments may be useful.

One of the primary drivers of H.R. 22 is the fact that a significant portion of bills, statements and payments will move from hard copy delivery to electronic alternatives some time in the future. Most of our member companies either have electronic options in place or are moving in that direction. However, we do believe that the majority of the bills and statements we produce will continue to be delivered by the United States Postal Service into the foreseeable future.

Generally, MMA supports H.R. 22 as written and completely objects to the Postal Service's recently introduced amendments. We believe these amendments do not support your efforts to have a strong Postal Regulatory Commission and to provide a means to have equitable rates across all classes of mail. We would like to comment on two broad issues that do concern us about H.R. 22 and they are as follows:

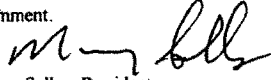
- Price Cap Ratemaking
- Private Law Corporation

Rate Cap Ratemaking – Our members have experienced the “boom and bust” ratemaking cycle over the years with the Postal Service and we endorse your efforts to attempt to achieve smaller and predictable rate increases. We also believe that holding the Postal Service to productivity gains and having baseline rates established through a rate case is appropriate. However, we are concerned that if the baseline rates for first-class mail do not correct the current situation in which first-class mail makes a disproportionate contribution to institutional costs, the problem will only be amplified with the rate cap proposal. We request that strong guidelines be given to the Postal Regulatory Commission (PRC) to correct this situation and to give the PRC the ability to set ambitious productivity gains.

Based on an annual review by the PRC on Postal expenses and revenues, we would also request that the PRC be given the authority to negate a rate increase in a given year when Postal finances dictate that there is no need to have an increase. We would also like to see a process in which some years from now, the PRC could invoke a rate case to affirm that the rate for each class of mail is at an appropriate level.

Private Law Corporation – We have read with great interest the testimony Chairman Gleiman provided to you on February 11, 1999. We have struggled for some time on how to articulate our problem with the Private Law Corporation (PLC) and were pleased that Chairman Gleiman was able to identify the issues so well. We are extremely concerned that under the PLC, the Postal Service would have the ability to offer any service or product they so choose or even go to the competitive marketplace and acquire customers and competitors. We believe that the Postal Service, through H.R. 22, should be required to concentrate on their core business and let the free market alone. Utilizing USPS finances to move into new types of business when there is still so much more to be done in the core business does not make sense.

In conclusion, we would like to see all of Chairman Gleiman's issues debated before finalizing H.R. 22. As with your efforts to define a fair and balanced Postal Reform bill, we have always found that the PRC has the best interest of the nation in mind. Thank you for this opportunity to comment.

A handwritten signature in black ink, appearing to read 'Mury Salls', is positioned above the typed name.

Mury Salls – President
Major Mailers Association
4388 Shackleford Road
Norcross, GA 30093

Statement of the Honorable Chaka Fattah
Ranking Minority Member
Subcommittee on the Postal Service
Hearing on H.R. 22, the Postal Modernization Act of 1999

Thursday, March 4, 1999

Mr. Chairman,

I am pleased to join Chairman McHugh and my colleagues at the second hearing on H.R.22. As a "work in progress", hearings on the bill before us are necessary if we are to fully and carefully understand the ramifications, debate the issues and define appropriate solutions.

The first hearing the subcommittee held last month on H.R. 22 was particularly enlightening to me and my colleagues. We had quite a lively discussion on the merits of a private law corporation, preserving universal service and the need to increase pricing flexibility and offer volume discounts by the postal service. We learned that price caps, for a labor intensive industry can impact wages. Postmaster General William Henderson also took a minute at the hearing to remind the Congress and the public that unlike others, the United States Postal Service delivers "everywhere, to everyone, everyday"!

Someone recently inquired as to my focus regarding postal reform legislation and today's hearing. Let me put it plainly. The American public via a recently released Associated Press poll, is happy with the postal service and they believe it is doing an excellent job. I want to build upon the job satisfaction expressed by the American public and focus on "People, Prices and Service." Postal reform must benefit the

public- the users and consumers of mail service and delivery. It must not result in price “sticker shock”, or a decrease or degradation in the quality of services rendered. In other words it must benefit the postal service and the public which relies upon it for its services. I was happy to note that same sentiment is shared by Kenneth Allen of the National Newspaper Association. In his testimony Mr. Allen states that “to date, little mention has been made of the postal ‘consumer’ or of Congress’s desire to lower postal rates for ratepayers.”

As a member of Congress, it is critical that my colleagues and I understand the bill before us and take comfort in knowing that its consideration will be a positive influence on mail delivery and services, uphold universal service obligations and place the postal service in the best position possible so that it can continue its mission and take advantage of changes in the marketplace.

To that end, I look forward to hearing from our panelists. I am pleased to hear from the Department of Justice. Your views, although not mired in rate making schemes and postal product baskets, are important if we are to understand the scope of change presented in H.R. 22. I also welcome FDX and UPS, the mainstays of parcel delivery and overnight service. And, where would the postal service be without its mailers and users – large and small, profit and nonprofit. With that,

thank you for coming. Rest assured your input is important.

**STATEMENT OF
ADVERTISING MAIL MARKETING ASSOCIATION
ON H.R. 22**

Mr. Chairman and members of the Subcommittee:

The Advertising Mail Marketing Association ("AMMA") welcomes this opportunity to comment on H.R. 22, a bill which would fundamentally alter the laws that govern the operations of the United States Postal Service.

AMMA is committed to the realization of postal reform. The simple fact is that the Postal Reorganization Act of 1970, now 30 years old, no longer reflects the economic, technological and competitive environment in which the Postal Service operates and will operate in the coming millennium. If the interests of all Americans are to be served, the Postal Service must be enabled to respond flexibly to the economic, technological and marketing challenges it now faces, to base its pricing and service determinations on prevailing conditions in the marketplace rather than theoretical, abstract and fundamentally unmeasurable cost-of-service considerations, and to compete fairly with enterprises in the private sector.

We believe the approach to postal legislative reform embodied in H.R. 22 - a system of price caps and safeguards designed to prevent cross-subsidies and unfair competition -- is conceptually sound. We also believe that the Subcommittee, and its able and very hardworking staff, can take satisfaction in the recognition that the Postal Service under its new leadership has come to recognize the validity of the concepts underpinning H.R. 22.

This does not mean that we unqualifiedly endorse H.R. 22 as it stands. AMMA has directly, and through The Mailers Coalition for Postal Reform, offered suggestions for improvement to H.R. 22. Some of these changes were accepted when H.R. 22 was marked up in the last session of Congress, and we deeply appreciate the Subcommittee's responsiveness to our concerns. Other concerns are unresolved and we look forward to working with the Subcommittee to bring these issues to closure as H.R. 22 moves forward in the current session of Congress.

Still less is AMMA prepared to accept all of the amendments that the Postal Service has now put forth. Several of the proposals that the Postal Service has advanced are (with some refinement or clarification) sound. Others are addressed to what we agree are real problems with H.R. 22 as it stands but miss the mark. Still others are unacceptable.

The statement of Jerry Cerasale on behalf of The Mailers Coalition for Postal Reform sets forth our collective solutions to certain of the critical problems

associated with H.R. 22 and the Postal Service's proposed amendments. We endorse it. We submit this Statement to elaborate on certain of the issues addressed in The Mailers Coalition's testimony.

A. *Negotiated Service Agreements.* AMMA has been on record from the inception of the movement toward postal legislative reform -- and even before -- in support of negotiated service arrangements. These arrangements yield benefits that go far beyond the immediate rate reduction accorded to the customer who has entered into the arrangement. Rather, negotiated service arrangements permit the Postal Service to creatively structure its relationships with regular customers in order to maximize the most efficient use of the system, thereby reducing overall cost -- including overhead cost -- in ways which benefit all mailers. We are grateful that the Subcommittee has recognized these values and benefits.

We believe that the substantive refinements to the provisions of H.R. 22 dealing with negotiated service agreements the Postal Service has proposed are sound. Specifically, the Postal Service's proposed language requiring that NSAs "be designed to result in net benefits to the financial condition of the Postal Service or the operation of a nationwide postal system" is both clearer and more accurate than the standard now embodied in H.R. 22. The Postal Service's amendment also recognizes that it is the net effect of an NSA, not its individual components, that is relevant to whether any particular negotiated service agreement meets that standard.

There has been some criticism of the procedures the Postal Service has proposed for the implementation of negotiated service agreements. We believe that the Postal Service's position on these matters is misunderstood. The Postal Service recognizes -- as we do -- that negotiated service agreements cannot, and should not, be immunized from regulatory review and that the essential terms of any NSA entered into must, in some fashion, be made public. But, there is a question as to how regulatory review should occur. We maintain that negotiated service agreements should be deemed presumptively valid, and should be set aside or nullified only on complaint by a competitor or mailer and that the complaining party should bear the burden of establishing why a particular negotiated service agreement should be nullified. The legislative language the Postal Service has advanced may not accurately capture these considerations, but the basic approach -- regulatory review only on complaint -- is sound and, indeed, parallels the process the FCC has used in its review of negotiated telecommunications rate agreements.

The need for legislative language to make absolutely clear that negotiated service agreements are presumptively in the public interest and are not to be interfered with by the regulators except upon valid complaint is unavoidable. There is, in some quarters, an unyielding resistance to the introduction of negotiated service agreements into the United States postal system. This

reluctance has persisted despite the overwhelming evidence showing that negotiated service arrangements have been used for decades in regulated industries in this country – including the telecommunications and energy industries – with nothing but beneficial effects. The resistance to negotiated service agreements has continued despite the fact that foreign postal administrations have been able to implement negotiated service arrangements in ways and on terms that have benefited all users of the postal system. Thus, we need more than a statute permitting such arrangements. Unless negotiated service agreements actually get approved, a provision in the law allowing such innovations would be meaningless. The solution to this problem is to place clear limits on the nature and extent of regulatory review.

B. Cost Coverage for Competitive Products. The requirement of H.R. 22 that the cost coverage of the competitive products equal (in aggregate) the cost coverage of the non-competitive products (in aggregate) is very flawed. The proposal advanced by The Mailers Coalition on Postal Reform is a reasoned solution to this problem.

No one contends that the Postal Service should be permitted to subsidize products in the competitive basket through revenues and profits that it derives from products and services in the non-competitive baskets and thereby compete unfairly with alternative delivery companies. The problem is that – despite its superficial “fairness” – this comparative cost coverage rule of H.R. 22 will not, in the long run, serve the interest of either mailers of non-competitive products or alternative service providers. Indeed, entirely without regard to what it will do to the Postal Service, the comparative cost coverage rule threatens to harm its intended beneficiaries.

The comparative cost coverage rule presumes that the Postal Service will be forced to maintain (and if necessary) raise rates for competitive products (taken as a whole) in order to match the aggregate cost coverage of the non-competitive products. The problem with this postulate is that maintaining or increasing competitive rates is not the only way to match coverages. Precisely the same result can be achieved by allowing variable or attributable costs in the non-competitive baskets to rise while holding non-competitive rates constant. This would have the effect of reducing the cost coverage of the non-competitive classes enabling the Postal Service to reduce rates for its competitive products. In other words, non-competitive mailers would not get the benefit of price caps – because of the continued use of cost coverages as a measure of rates – while at the same time the attempt to protect competitors of the Postal Service from “unfair competition” will also have failed.

The real problem is that comparative cost coverages are not a measure of the existence or non-existence of cross subsidies or of the existence or non-existence of predatory prices. Nor is the rule necessary to guard against these legitimate concerns. H.R. 22 contains a number of structural, accounting and

procedural safeguards to ensure that the Postal Service and the private law corporation do not engage in unfair competition through predatory pricing and do not attempt to subsidize the offering of competitive services on the basis of revenues and profits derived from products in the non-competitive baskets. We, therefore, ask the Subcommittee to reconsider whether the comparative cost coverage rule is necessary.

At the very least, the application of this comparative coverage policy ought to recognize that the existing coverages are presumptively just and reasonable. The Mailers Coalition for Postal Reform proposes, instead of a comparative cost coverage, that there be a minimum aggregate cost coverage for competitive products, that this coverage floor be computed on base rates, and that this aggregate floor sunset after 5 years. The compromise offered by The Mailers Coalition for Postal Reform deserves the Subcommittee's serious and favorable consideration.

C. The Adjustment Factor. Under H.R. 22, the postal price index is determined by a formula using CPI minus an "X Factor" -- representing productivity -- that is to be determined periodically by the Postal Regulatory Commission. The Postal Service proposes to eviscerate the adjustment factor. Under its amendments, the adjustment factor would "ordinarily" be set at zero and a negative adjustment factor would be allowed "only upon a written determination by the [Postal Regulatory Commission] that an exception . . . is necessary because compelling evidence indicates that Postal Service productivity during the upcoming ratemaking cycle will consistently exceed" a productivity index maintained by the Bureau of Labor Statistics. This complete elimination of productivity considerations from the price cap formula is bad enough. But, the Postal Service compounds the problem by providing for a *positive* adjustment factor to deal with the issue of "exogenous costs" -- costs over which the Postal Service has no control and that are imposed upon it by executive, judicial, legislative or administrative requirements.

Under the Postal Service's amendments, rate increases for the non-competitive categories of mail will *always* equal or exceed the rate of inflation, regardless of how well the Postal Service manages its costs. As one prominent member of the AMMA Board put it: "The Postal Service has removed the goalie."

We urge the Subcommittee to categorically reject the Postal Service's proposed changes to the adjustment factor. The central premise of price cap regulation is that revenues should drive expenditures, rather than the other way around, and that the reward for maintaining rates at or below the cap is the ability of all postal employees to share in the resultant profits. The existence of a negative adjustment factor is integral to price cap rate regulation. It is the only means by which there can be assurance that the profits that the Postal Service enjoys have been legitimately earned through increased efficiency in its

operations. Profits are not legitimate if they are achieved simply by raising rates to match the CPI.

Price cap regulation is not designed solely to free the Postal Service from cost of service constraints. It is also intended to require the Postal Service to share with its captive customers, through stable and reduced rates, the rewards to the Postal Service as an institution will receive, once it is freed from the artificial constraints of current law. The Postal Service's proposal that the adjustment factor be set ordinarily at zero robs captive mail users of virtually all of the benefits that they would otherwise derive from price cap regulation.

In his testimony before this Subcommittee last month, Postmaster General Henderson stated that "a reorientation" of the Postal Service "to a higher level of expectation in terms of efficiency, market orientation and competitiveness . . . will not be comfortable . . . or easy." We are not insensitive to this reality. Nor does it serve anyone's interest to establish standards that the Postal Service simply cannot meet. But, with or without H.R. 22, the Postal Service is going to have to face challenges in the coming millennium. Foremost among these is the need to increase its efficiency. There is a clear difference between setting too high a standard on the one hand, and, on the other, incorporating into legislation goals which the Postal Service must achieve in any event. Moreover, exogenous costs should be dealt with entirely outside of the price cap system as the FCC and other agencies that have implemented price cap regulation have done. In short, there is nothing in the Postal Service's approach to the adjustment factor that merits consideration by the Subcommittee.

D. Rate Flexibility. AMMA shares the view of the Postal Service that the provisions of H.R. 22 relating to rate bands are too tight and, therefore, unduly restrictive on the Postal Service. As we read it, under H.R. 22, each change in a rate of a "subordinate unit" (or rate element) that exceeds the maximum permitted price index (within the permitted band) must be matched by a reduction of another subordinate unit or rate element in the same basket so that effectively rate adjustments at the rate element level offset one another and are revenue neutral. This approach is too rigid.

The Postal Service's alternative is altogether too fluid. Under the Postal Service's amendment, the postal price index would be determined at the basket level but the bands would apply, on a revenue weighted basis, to the rate elements. The problem with this approach is that the baskets in many cases -- and notably in the case of Basket 4 -- contain mail which is wholly dissimilar in all relevant respects. The subclasses within each basket, however, contain mail which, as a general proposition, has very similar characteristics. The result is that mailers may make very heavy use of rate elements from one or two subclasses within a basket but little or no use of other subclasses within the same basket. For example, a catalog mailer is very likely to make significant use of rate elements in the Enhanced Carrier Route and Standard (A) Regular

subclasses but will make little, if any, use of bulk bound printed matter or of Special Standard (B) (the "book rate"). Under the Postal Service's approach to the issue of rate flexibility, it would be permitted to increase rates for one subclass above postal price index (up to the band) but nonetheless maintain consistency with the postal price index by zeroing out, or even reducing, rates -- again within the band -- for other subclasses within the same basket.

The net effect would be that some mailers are virtually assured of receiving annual rate increases that exceed the postal price index. Such a result would be fundamentally inconsistent with the core purposes of price cap regulation. As applied in the postal context, price cap regulation contemplates that mailers with homogenous characteristics will, on average, experience increases that are not greater than the postal price index. Unlike the telecommunications field -- in which each of the baskets is, in fact, composed of homogenous users and technologically undifferentiated services -- in the postal environment there are very real differences between users and the nature of mail in each basket, and this is especially true in Basket 4.

Fortunately, there is a simple and straight-forward solution to this problem which appropriately balances the Postal Service's legitimate interest in greater rate flexibility with the basic principles of fairness that underlie the price cap system. AMMA submits that the Postal Service should be allowed to adjust rates assigned to "subordinate" rate elements within the bands. However, the law should provide that the *average increase applied to any subclass* within a basket may not exceed the maximum price permitted by the postal pricing index. This approach to rate flexibility is consistent with the approach the Subcommittee itself took in H.R. 3717 and, unlike either the Postal Service's amendments or H.R. 22, provides the Postal Service with a very significant measure of rate flexibility without unfairly disadvantaging mailers.

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COMMITEE ON NATIONAL SECURITY

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Testimony of Duncan Hunter
House Postal Service Subcommittee
March 8, 1999

Mr. Chairman, Members of the Subcommittee, thank you for the opportunity to submit testimony on HR 22, the Postal Modernization Act of 1999. Since I testified before you two years ago, a lot has happened in this area. Under your leadership, Mr. Chairman, the postal reform bill has been rewritten in great detail and contains many fine changes. My testimony will be targeted to one specific issue, competition by the Postal Service against private small businesses.

Earlier this year, I again introduced H.R. 198, the Postal Service Core Business Act. As you already know, this bill seeks to protect small businesses from unfair competition by the United States Postal Service (USPS), while still maintaining the viability of the federal agency to conduct its Constitutionally mandated core business: the universal delivery of mail.

Nearly two decades ago, an industry of small businesses called Commercial Mail Receiving Agents (CMRAs) began in San Diego, California. CMRAs, more commonly known by their commercial brand names: Mailboxes, Etc; Postal Annex; and Parcel Plus, began because their founders saw a need within the community for specific services. CMRAs provide material and help their customers pack parcels to ensure safe delivery; they help customers identify the most efficient and cost-effective manner in which to send their packages; they oversee mailboxes and offer personalized postal services to their customers; as well as many other additional services.

These services simply were not provided by the USPS five years ago. Given the rate by which this industry has exploded over the last two decades, however, it is clear that there was a need within our communities. In a very short time this industry has grown to include more than 10,000 independently owned and operated stores located in every state in the nation. This is a glowing success story of small businesses in America. Unfortunately, these small businesses became the target of the USPS. Recognizing this demand, the USPS decided to offer these same

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House Postal Service Subcommittee
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services, in many cases right next door to the small mom and pop stores.

Suddenly, small CMRAs were required to compete against the federal agency that historically had been a partner in their efforts to deliver their services. To further complicate the issue, the USPS, as a federal agency, regulates the CMRA industry and has many taxpayer supported advantages that it uses to compete with these small businesses. They are as follows:

1. The USPS does not charge tax on its retail items—which results in a 5 to 10% advantage.
2. The USPS is self-insured as an agency of the US government—small business CMRAs have to purchase insurance.
3. The USPS does not have to make a profit—there is nothing that requires them to be profitable. When they are under threat of not breaking even, they request a postal rate increase, similar to the one recently applied.
4. The USPS borrows money from the U.S. Federal Reserve at the most favorable rates—CMRAs have to borrow money at market rates.
5. The USPS has a congressionally authorized monopoly on the delivery of first class mail, the revenue of which can be used to subsidize other services and products.

Mr. Chairman, as you know, I am a strong supporter of the U.S. Postal Service. Like every American I depend on the hard work and dedication of Postal Service employees for the timely delivery of my mail six days a week, and I want to ensure a strong USPS. Further, I believe that universal service is something that must be protected as it ties our communities together. I do not think, however, that the USPS should compete with private businesses by offering services other than standard postal services for its revenue. It is for this reason that I introduced H.R. 198, which states the USPS should not offer any non-postal services that it did not offer, nationwide, as of January 1, 1994.

Over the last several years I have met with many representatives from the postal community and received much input regarding this legislation. I am hoping to work with you and your committee to address some of these concerns to ensure that Americans receive the best postal services available. Specifically, I would be interested in modifying my bill to allow rural post offices, in communities that cannot support an independent CMRA, to provide some additional services to their customers. I believe, however, that in communities where private businesses have taken the initiative to provide the services, they shouldn't suddenly be forced to

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compete with a federal agency.

Mr. Chairman, you should be commended for your work on this issue. Many of the provisions that you are advocating will go a long way towards protecting the USPS in the future. I do, however, have several reservations about the expanded authority of the USPS as stipulated in H.R. 22. Specifically, I am concerned about the impact of the proposed Public Law Corporation (PLC) on small businesses across the country.

Before the PLC could become effective as a funding offset to maintain low stamp prices, the corporation would have to be amongst the largest in the country. Just recently, the USPS implemented a one cent stamp increase, the smallest increase in more than a decade. That one cent is expected to yield nearly \$1 billion in revenues over the next year. That exceeds the profits of most Fortune 500 companies. Mr. Chairman, I have deep reservations about creating a government mandated PLC that will compete against both big and small companies in order to achieve its goal of huge profits. To add to my concern, according to a recent GAO report (99-15), the USPS has actually lost millions in their efforts to offer non-traditional services. I know that you have worked hard to develop "fire walls" and other mechanisms to keep the PLC separate from the USPS, however, my concerns remain.

Mr. Chairman, I look forward to working with you and your committee in the coming months to perfect this bill and thereby protect small businesses from unfair competition with the U.S. Government.

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TESTIMONY OF
ASSOCIATION OF AMERICAN PUBLISHERS
ON H.R. 22, THE POSTAL MODERNIZATION ACT OF 1999

BEFORE
THE SUBCOMMITTEE ON THE POSTAL SERVICE
COMMITTEE ON GOVERNMENT REFORM AND OVERSIGHT
HOUSE OF REPRESENTATIVES
CONGRESS OF THE UNITED STATES

MARCH 4, 1999

TESTIMONY OF
ASSOCIATION OF AMERICAN PUBLISHERS

AAP is the national association of book publishers. It has over 200 members which encompass large and small publishing houses, as well as university, religious and non-profit publishers. AAP's members use all classes of mail for business purposes, but they particularly use Standard B mail – bound printed matter, special standard and library rate – to distribute books and other educational materials to the public. AAP members also make use of Standard A mail to send journals which make use of periodicals and non-profit mail classes. We actively participate in postal rate cases and other proceedings before the Postal Rate Commission in pursuit of our strong interest in an efficient and economically viable postal service. AAP appreciates the opportunity to present its views on H.R. 22 the Postal Modernization Act of 1999.

AAP consistently has supported Congressman McHugh and the members of the Subcommittee on the Postal Service in their efforts to reform the postal rate-making system. AAP testified on the original version of the legislation, H.R. 3717 in September 1996 and, in March 1998, provided written comments to the Subcommittee pertaining to the revised version of the legislation. AAP continues to believe that, in the long-term, changes to the ratemaking process contemplated by the legislation will serve the best interests of its members provided that such changes result in greater rate stability and include incentives for the Postal Service to control costs.

AAP believes this even though its members traditionally have benefited from the current ratemaking criterion which requires that the Postal Service consider the educational, scientific, cultural and informational value of the mail matter when establishing rates. Under the proposed legislation, this criterion would be considered only in the baseline rate case, but not for purposes

of establishing or changing adjustment factors in subsequent rate cycles. The current system, based on policy considerations which take into account the value of the mail matter such as books and journals, will be replaced by a process which only takes economic factors into account.

While AAP continues to believe that content should be a consideration in future rate-making processes, it believes that rate stability and incentives for the Postal Service to control costs must be the primary goal of the legislation. The need for rate stability is underscored by the recent rate case in which some classes of mail, particularly those used by AAP journal publishers, saw rates increase by as much as 8.0%. AAP believes that the legislation's reliance on price-caps and banding requirements serves this goal, as does the requirement that the adjustment factor – which is based on productivity – be no more than zero. Over time, AAP is confident that its members' interests will best be served by this rate-making model as rate increases will be more gradual and predictable. The legislation also contains significant incentives for the Postal Service to control its costs and to operate in a more efficient manner.

AAP is concerned, however, that many of the Postal Service's proposed changes would weaken these incentives and undercut the legislation's attempt to create stability and predictability in the ratemaking process. For example, the Postal Service seeks to adjust the rate-cap by eliminating the negative adjustment factor in all but compelling circumstances. The Postal Service also proposes to allow adjustments that, in some cases, would exceed growth in the CPI and to permit cumulative banked increases to be applied on a yearly basis. AAP understands that this approach would be further compounded by permitting banding of over 1.5% the cumulative increase.

The Postal Service has ignored the fact that the price-cap, the adjustment factor and banding provisions set forth in H.R. 22 are designed to foster rate stability and not to permit the Postal Service to steadily increase rates on a yearly basis – rate increases that Postal Rate Commission Chairman Edward Gleiman estimates might be as much as 4.5% per year. Under these revisions, the rate stability contemplated by the current legislation would no longer exist, and AAP's members would not only lose the benefit of a criterion based rate-making system based, in part, on content but also become subject to the possibility of frequent and significant rate increases. AAP encourages the Subcommittee to refrain from making additional changes to the legislation which undercuts the rate stability and incentives for the Postal Service to control costs that the legislation was designed to promote.

There are, however, several aspects of the Postal Service's proposed revisions which AAP believes should be considered. First, the Postal Service proposes that baseline rates be those in effect eight months after the enactment of H.R. 22. Consistent with its concern that rates remain stable, AAP believes that there is no need for an omnibus rate case if there has been a rate case within 18 months of the date upon which the legislation is enacted. In fact, the original version of the legislation proposed this same exception to the omnibus rate case requirement.

AAP also is encouraged by the Postal Service's proposal to improve the negotiated service agreement provisions of the legislation. The ability of mailers and the Postal Service to enter into such agreements needs to be structured in a feasible manner which takes into account the work-sharing efforts which mailers are prepared to undertake in order to obtain such agreements. AAP believes that the Postal Service's approach to negotiated service agreements provides significant incentives for mailers to maintain their relationship with the Postal Service. Such agreements, however, must cover the costs of the agreed upon discount. Provided that the

legislation requires that such agreements cover the attributable costs of discounts, AAP believes that such agreements will strengthen the Postal Service's competitive position and result in better service to the public.

AAP appreciates the opportunity to provide additional testimony regarding these issues and commends the Subcommittee on its thorough and thoughtful approach to postal reform. Consistent with this approach, AAP encourages the Subcommittee to continue this process by ensuring that any changes to the proposed legislation not alter the original legislation's vision of a fair and balanced rate-making system aimed at bringing about greater rate stability and predictability. AAP would welcome the opportunity to discuss these and other issues with the Subcommittee staff at a later time.



Pitney Bowes

Vice President
Federal Relations

March 12, 1999

The Honorable John M. McHugh
Chairman
Subcommittee on the Postal Service
Committee on Government Reform
U.S. House of Representatives
Washington, DC 20515

Dear Mr. Chairman:

Thank you for the opportunity to comment on H.R. 22, the Postal Modernization Act of 1999.

This is our second opportunity to comment formally on proposed postal reform legislation. On April 7, 1998, Pitney Bowes commented on a previous version of H.R. 22. As we said then, we agree with you that the Postal Service provides a fundamental service to the American people – universal mail service at affordable rates. We support efforts such as yours to enable the Postal Service not just to survive but to thrive and continue to provide the American public with a highly efficient cost-effective communications tool. The business of the Postal Service is the collection, processing, transportation, and delivery of mail.

Pitney Bowes strongly supports H.R. 22. This year's version is greatly improved over last year's. Those provisions that preclude the Postal Service from using its governmental authority, particularly its regulatory authority, to favor itself or the USPS Corporation authorized by the bill are important additions (see proposed 39 U.S.C. 404a (section 305 of the bill)).

H.R. 22 also properly seeks to clarify the mission of the Postal Service and ensure that it will focus on its core "postal" business. It distinguishes between "postal" and "nonpostal" products and prohibits the Postal Service, which remains a part of the U.S. Government, from providing new "nonpostal" products.

The bill provides new "commercial freedom" the Postal Service says it needs. There is increased pricing flexibility for its "noncompetitive" postal products such as First-Class Mail, periodicals, and advertising mail, including limited authority to negotiate prices with individual customers. It also provides virtually unfettered freedom to price "competitive" postal products such as Express Mail, Priority Mail, and parcel post. While this proposed "commercial freedom" may be less than that sought by the Service (and perhaps more than that desired by its competitors), the bill does strike a balance by enhancing the Postal Service's ability to compete while curtailing many of the inherent governmental advantages it now enjoys.

Discussion

Prohibit regulatory abuses and prevent unfair competition.

This year's bill addresses some of the concerns Pitney Bowes raised last year.

- It prohibits the Postal Service from using its regulatory authority to provide a competitive advantage to itself or its wholly owned corporation.
- To avoid unacceptable conflicts of interest, it prohibits the Postal Service from competing in markets that it substantially regulates with respect to competition.
- It prohibits the Postal Service from investing in private sector businesses.
- The bill establishes a more effective enforcement (complaint) process.

Focus USPS on its core function.

Successful businesses today all share a common philosophy: the need to maintain management focus on core products and competencies in order to deliver superior customer value. Through a process of continuous improvement successful companies become the providers of choice of superior core products and services to an ever-expanding customer base.

Pitney Bowes supports the intent of the bill to focus the Postal Service on its traditional responsibility of accepting, collecting, sorting, transporting, and delivering physical mail – letters, printed matter, and packages. We believe, however, that H.R. 22 could be improved to clarify what is and is not permitted by the Postal Service and to ensure that the Postal Service does not enter markets already served by the private sector (e.g., e-commerce, postage payment evidencing, and packaging services). H.R. 22 appropriately embodies the view that the private sector should be allowed and encouraged to continue to develop innovative, competitive solutions.

Benefit the mail user.

Postal policies, programs, and operations must be judged by their effect on those using the mail system (senders and recipients). The Postal Service must not implement any policy, program or operation if it has the effect of discouraging or discontinuing the use of mail by mailers and recipients of mail. Lower prices for postal services will increase demand. But it is the end-to-end cost to the user that is important.

Thus to promote the competitiveness of postal services, the Postal Service must not design new processes and standards or adopt new technologies that focus only on reducing the costs of its operations or only the cost of postage. Rather, it needs to take into account end-to-end (total system) postal costs. Any change that increases operational efficiencies but shifts significant costs to the users of the system is counter-productive. If the cost to the user remains too high and less costly alternatives exist, customers will choose other forms of messaging.

For example, the bill should require that in establishing rates for noncompetitive products, the Postal Service Directors must take into account, to the maximum extent practicable, costs imposed on mail users by the Postal Service. When the Postal Service requires cooperative efforts from its customers to cut costs or improve service and those efforts produce savings for the Postal Service, the customers should enjoy the benefit of those savings. "Worksharing discounts" are price reductions designed to recognize work performed by mailers that reduce processing, transportation, or delivery costs of the Postal Service. Examples of "worksharing" include presorting, prebarcoding, and dropshipping. Another example is metered mail. The cost to the Postal Service of processing metered mail is significantly less than that for stamped mail. Metering is a cost-effective method of payment evidencing and incentives should be provided to encourage its use. H.R. 22 should require the Postal Service Directors to establish rates that reflect Postal Service costs avoided as a result of the worksharing efforts of its customers.

Clarifying the distinction between postal products and nonpostal products.

An underlying policy of H.R. 22 is that nontraditional products and services should be offered by the Government, if at all, only through the independent, for-profit USPS Corporation. The Postal Service itself should not offer these products. Pitney Bowes believes this policy should be clarified so that the Government's role remains its traditional one – accepting, collecting, sorting, transportation, and physical delivery of mail. Services already provided by the private sector before or after a mail piece is in the custody of the Postal Service should remain the province of the private sector. These services include creating or printing a mail piece or addressing, sorting, evidencing postage payment (including the distribution of, or accounting for, such payment), or opening a mail piece.

Also we believe those provisions of title 39, United States Code, relating to the general and specific powers of the Postal Service, should be amended to conform to the bill's policy regarding appropriate new services for the Postal Service to offer (see e.g., 39 U.S.C. 401, 404(a)).

Banking, borrowing, and investing.

H.R. 22 would relax statutory restrictions on the USPS's banking, borrowing, and investing activities. Those activities today are subject to Treasury Department control. We agree that the USPS should be given more financial freedom to manage its cash flow and "make money on its money," as proposed in H.R. 22. With more than \$60 billion in annual revenues, it has daily cash balances of hundreds of millions of dollars. The USPS, however, should not be allowed to invest in private sector businesses. H.R. 22 correctly prohibits this. We support this prohibition.

Grant federal district court jurisdiction over actions against the USPS Corporation.

H.R. 22 should be amended to clarify that U.S. district courts and, where appropriate, State courts will have jurisdiction over allegations that the USPS Corporation has violated provisions of Federal law (including the unfair competition provisions of proposed 39 U.S.C. 404a) or State law. To the maximum extent practicable, the Corporation is to be treated as a

private commercial entity. Thus, it should not be subject to the jurisdiction of the Postal Regulatory Commission, a Federal regulatory agency created to regulate only one Governmental entity, the Postal Service.

Strengthen the “firewalls” between Postal Service and the private, for-profit USPS Corporation.

Pitney Bowes proposes four changes to strengthen the “firewalls” between the USPS and its subsidiary, the USPS Corporation.

First, the bill should require that at least 25 percent of the shares issued by the Corporation shall be offered for purchase by the general public. This ensures accountability for the Board of Directors beyond that which would flow to its Governmental parent the Postal Service. Similarly, the bill should ensure that not more than 75 percent of the shares issued by the Corporation may be purchased by the Postal Service.

Second, the bill should be amended to make explicit what is only implied – the Corporation directors are subject to the laws of the State or States in which incorporated, including laws relating to fiduciary responsibility.

Third, those provisions of the bill that exempt Corporation officers and employees from the “revolving door” provisions of the Ethics in Government Act (18 U.S.C. 207) should be deleted. These “revolving door” provisions that generally will apply to former officers and employees of the Federal Government employed by competitors of the Corporation, should apply to officers and employees of the Corporation as well to preclude the Corporation from obtaining an unfair competitive advantage, i.e., hiring former postal officials to immediately represent the Corporation with their former employer, the Postal Service.

Finally, the bill should provide that if the Postal Service provides goods and services to other commercial entities, it must provide equal access to those goods and services to other commercial entities, again ensuring the Corporation enjoys no unfair competitive advantage. “Commercial entity” means any corporation, company, association, partnership, joint stock company, firm, society, or other similar entity.

Ensure the ability of the Postal Service and the USPS Corporation to adopt new technologies.

Pitney Bowes believes H.R. 22’s provisions relating to unfair competition are crucial if the Postal Service and its subsidiary USPS Corporation are to be given expanded “commercial freedom.” These provisions (proposed 39 U.S.C. 404a (section 305 of the bill)) prohibit the Postal Service and the Corporation from using governmental authority to affect competition or provide a competitive advantage to any person. They promote a “level playing field” in the provision of postal and nonpostal products and services.

Neither the Postal Service nor the Corporation, however, should be prohibited from conducting business with “any other person” solely because only that person, or a limited

number of persons, have the technology, expertise, or capacity to provide a particular product or service.

Reject the USPS proposal to weaken the unfair competition provision.

The Postal Service proposes a change to the provisions of H.R. 22 that address unfair competition (proposed 39 U.S.C. 404a (section 305 of H.R. 22)). The USPS proposal would significantly narrow the application of section 404a by excepting from its prohibitions actions of the USPS "incidental, necessary, or appropriate to the transaction of business with the Postal Service . . ." Its explanation asserts that "the Postal Service requires the authority to prescribe rules, standards, and procedures for the conduct of its own business. Whether they take the form of mail acceptance procedures, packaging standards, or postage payment systems, these 'regulations' are essential to the efficient and orderly operation of the mail system."

Pitney Bowes agrees that the Postal Service should be able to conduct its business efficiently and without the threat of unwarranted litigation, but the result of its proposed changes is much more. Essentially, the Postal Service amendment would permit it to prescribe, by regulation, acceptance procedures (e.g., minimum volume requirements) that favor its own service such as it has proposed in the pending Mailing Online Case (PRC Docket No. MC98-1). This "exception" could also be used by the Postal Service to favor its Shipping Online program. Shipping Online is, in essence, a postage payment evidencing system similar to metering. Analogous systems provided by the private sector would be subject to Postal Service regulations "incidental . . . to the transaction of business with the Postal Service." These regulations could afford competitive advantage to the Postal Service. Similarly it could promulgate, by regulation, packaging requirements that favor its own packaging service ("Pack & Send") over those provided by competitors such as Mail Boxes, Etc. This is the type of misuse of regulatory authority that H.R. 22 seeks to prohibit. The amendment should be rejected.

Reject USPS proposal to weaken enforcement (complaint) process.

H.R. 22 includes a greatly strengthened enforcement process administered by the Postal Regulatory Commission (PRC). The PRC is given jurisdiction over complaints that allege violations of law by the Postal Service such as violations of provisions:

- governing minimum and maximum rates for noncompetitive products (39 U.S.C. 3732);
- requiring prices for competitive products to cover attributable costs (39 U.S.C. 3743);
- prescribing conditions to be met by new competitive products (39 U.S.C. 3763);
- prohibiting discrimination (39 U.S.C. 403(c));
- prohibiting the use of regulatory authority to secure competitive advantage (39 U.S.C. 404a); and

- prohibiting the offering of new nonpostal products (39 U.S.C. 404).

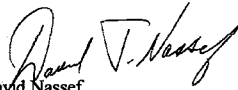
In each above instance, the PRC is given the necessary authority to order appropriate relief if it finds a violation has occurred.

Postal Service amendment No. 26 would eliminate the PRC's authority to order relief in key instances such as where it finds unlawful discrimination or abuse of regulatory authority. Instead, the Postal Service proposes that "in such cases, the Commission would issue a public report to the Postal Service, which would then face the need to take appropriate remedial action." In effect, the offending party would determine the relief, if any, that would be afforded the aggrieved one. This result is unacceptable and the amendment should be rejected.

Conclusion

Thank you for the time, effort, and care you, your colleagues on the Subcommittee, and your staff have devoted to modernizing the laws governing postal services in the United States. Thank you also for this opportunity to comment on your efforts thus far. We look forward to continuing to work with you as this process proceeds.

Sincerely,



David Nassef

Vice President, Federal Relations

Parcel Shippers Association

March 8, 1999

The Honorable John M. McHugh
Chairman
Subcommittee on the Postal Service
Committee on Government Reform
U.S. House of Representatives
Washington, DC 20515

Dear Mr. Chairman:

The Parcel Shippers Association (PSA) appreciates this opportunity to express its support for H.R. 22, the Postal Modernization Act of 1999.

I am Win Zimmermann, the President of PSA. My company, The Swiss Colony, is a long-time member of PSA. The Swiss Colony, established in 1926, was the first mail order cheese business in the United States. Since then, we have become Santa Claus to the entire country.

PSA was established in 1953. It represents about 200 businesses that use the United States Postal Service and other carriers to ship parcels in interstate commerce. Many of our members are heavily dependent on the Postal Service and its ability to continue and compete effectively is very important to us. We particularly support the "deregulation" of parcel post and other competitive products proposed in H.R. 22.

PSA joined in the testimony of the Mailers Coalition for Postal Reform, and we fully support the views expressed in that testimony. My comments focus on two issues of particular importance to parcel shippers: the appropriate "mark-up" for competitive products, and the status of small (Standard A) parcels.

The appropriate mark-up for competitive products.

Packages are a big business. The Postal Service estimates that in 1997 Americans shipped more than 7.4 billion packages, generating \$39.3 billion in revenue. And, there is significant competition in this market. The Postal Service share of the overall pie was \$5.4 billion, and \$3.8 billion of that derived from Priority Mail. Different players lead different parts of this market. Again according to the Postal Service, the market shares and projected growth of the Overnight, 2-Day, and Ground package business are as follows:

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	1997 Market Leaders	Projected Growth (1998-2003)
Overnight	Federal Express @ 45%	3.5% per year
2-Day	U.S. Postal Service @ 63%	14% per year
Ground	United Parcel Service @ 83%	7.4% per year

Under H.R. 22, package services such as Overnight, 2-Day, and Ground offered by the U.S. Postal Service would be deregulated partially. The Postal Service would be free to set its rates and even negotiate contract rates with individual customers subject to two conditions. First, each rate must cover the attributable costs of the service involved. Second, revenues from competitive products in the aggregate must at least be sufficient to contribute a proportionate amount to the overhead, or common, costs of the Postal Service when measured against the contribution of noncompetitive products. This is the so-called "equal mark-up rule."

In postal ratemaking, overhead contribution is measured by dividing revenues by attributable costs to obtain a "cost coverage." Under the equal mark-up rule, if revenues from noncompetitive products, as a whole, produce a cost coverage of 150%, then revenues from competitive products, as a whole, must be sufficient to produce a coverage of 150%.

The issue here is fairness. The theory is that the equal mark-up requirement precludes the Postal Service from using revenues from noncompetitive products to unfairly subsidize rates for competitive ones. But is equal necessarily fair?

For nearly three decades "coverages" for postal products and services have been set through Postal Rate Commission (PRC) regulatory process. Overhead costs are "assigned" based on nine factors set out in the Postal Reorganization Act such as fairness and equity, value of mail service provided, and available alternative means of service (39 U.S.C. 3622). As a general matter, those coverages have been deemed "fair."

H.R. 22 requires one last rate case, the Baseline Case, before the new pricing regime it establishes is implemented. Coverages for postal products and services will be determined in that case. PSA believes that those coverages should determine the overhead burden borne by noncompetitive products, as a whole, and competitive ones. This approach is preferable to establishing an arbitrary rule by statute.

I must admit, we have been somewhat frustrated in our efforts to determine a fair approach by the lack of meaningful data. Despite our best efforts, we still do not have any official indication as to the shift in overhead burden that would be required by the equal mark-up rule. The best informal estimate we have received suggests the rule would require a ten percent increase in prices for competitive products. This, of course, is not only unfair to parcel shippers it is totally unacceptable.

Our concerns were only heightened several weeks ago when we learned the Postal Service has been underestimating parcel post volumes and revenues. Indeed, in 1998 parcel post volumes were underestimated by about 50 million pieces and revenues by \$124 million dollars. Since costs did not change, this means the overhead contribution from parcels was \$124 million more than the amount recommended by the PRC and approved by the Postal Service Governors in the last rate case. Our General Counsel's letter to the Postmaster General discussing this problem is enclosed.

Finally, PSA agrees with the Postal Service and the Mailers Coalition that the rule requiring a minimum contribution from competitive products should sunset. Five years seems like a reasonable period.

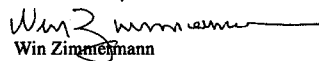
Standard A parcels.

Standard A parcels are lightweight (under 16 ounces) parcels. Under H.R. 22 these parcels are placed in the noncompetitive category. PSA believes this is appropriate since there is virtually no competition to the Postal Service for this market.

The Postal Service proposed amendments, however, appear to place these products in the competitive category, a result that we understand was unintended. PSA supports the H.R. 22 approach.

Mr. Chairman, PSA's members and member of the entire mailing community deeply appreciate the efforts of you, your colleagues on the Subcommittee, and your staff over the last four-plus years. We look forward to continuing to work with you as H. R. 22 makes its journey through the legislative process.

Sincerely,


Win Zimmermann
President

Encl:

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ATTORNEYS AT LAW

2550 M Street, NW
Washington, DC 20037-1350
202-457-6000
Facsimile 202-457-6315

February 03, 1999

Timothy J. May
202/457-6050

Postmaster General William Henderson
United States Postal Service
475 L'Enfant Plaza West SW, Room 10022
Washington, D.C. 20260-0010

Dear Postmaster General Henderson:

I am writing to bring to your attention facts about which you may not be aware. Beginning with the first quarter of FY 1999, the Postal Service began to utilize a different methodology for counting the revenue and volume of Standard B parcel post. As the Postal Quarter 1 RPW notes, this new methodology was simply to begin using mailing statements to estimate the parcel post volume and revenue, a practice that had long before been adopted for other classes and subclasses of mail. This more accurate method of accounting for parcel post volume and revenue discloses that previous revenue and volume estimates were underreported to a staggering degree. In round numbers, FY 1998 parcel post pieces were underestimated by around 50 million, and the revenue produced from parcel post was underestimated by over \$124 million. To put this in perspective, (because parcel post volumes are relatively small compared to other subclasses of mail), the size of the error is the equivalent of underestimating first class mail by 20 billion pieces and \$5 billion.

We should point out that, while the volume and revenue estimates were inaccurate, there is no change in the projected costs for parcel post. The significance of this is that it means that, on a per piece basis, parcels on average cost the Postal Service 40¢ less than the Postal Service reported to the Postal Rate Commission that they did.

As a practical matter, it means that, if the correct numbers had been used in the last rate case, rather than proposing a 9% increase for parcel post, the largest increase proposed by the Postal Service for any subclass of mail, the Postal Service should have asked the Commission for a substantial rate reduction for parcel post. Based upon what now know to be very inaccurate revenue and piece numbers, the Commission recommended an even higher rate increase for parcel post than you had proposed.

The information that I am reporting to you in this letter has been confirmed by your staff that deal with these kinds of numbers, and by the staff of the Postal Rate Commission.

PATTON BOGGS LLP
ATTORNEYS AT LAW

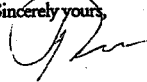
Postmaster General William Henderson
February 03, 1999
Page 2

The question it seems to us is what the Postal Service intends to do to correct what is a manifestly inequitable rate situation for parcel post users, an inequity that apparently has endured for many years because of the inaccurate reporting of revenue and piece data on parcel post to the Postal Rate Commission for rate making purposes. It is certainly not the first time that the Postal Service and the Postal Rate Commission have used inaccurate data. However, never in the twenty-eight years that I have been dealing with the establishment of rates by the Postal Service and the Postal Rate Commission has any major subclass of mail been the victim of such egregiously bad data.

I would appreciate it very much if you could set aside time in your busy schedule to meet with the new Executive Vice President of the Parcel Shippers Association, Pierce Myers, and myself to discuss what possible remedies may exist to rectify this very serious injury to parcel post users.

I will take the liberty of calling your office to see when it would be convenient for Mr. Myers and myself to meet with you.

Sincerely yours,



Timothy J. May
General Counsel, Parcel Shippers Association

TJM/ecc

bcc: Mr. James Pierce Myers
Mr. Thomas P. McKeever

APMU ASSOCIATION OF PRIORITY MAIL USERS, INC.

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April 27, 1999
Hand Deliver

Hon. John McHugh
Chairman
Subcommittee on the Postal Service
Committee on Government Reform
U.S. House of Representatives
B349C Rayburn House Office Building
Washington, DC 20515

Dear Mr. Chairman:

Thank you very much for the opportunity to present comments on behalf of the Association of Priority Mail Users ("APMU") regarding H.R. 22, the Postal Modernization Act of 1999. We apologize for submitting comments so close to the markup session, but believe that these views are important for your Subcommittee to consider.

We want to alert you to the fact that the proposal in H.R. 22 (section 3744), requiring the overall percentage contribution to institutional costs from "competitive" products to be equal to or greater than the percentage contribution to institutional costs from all mail, could badly damage the Postal Service's flagship product, Priority Mail.

Association of Priority Mail Users, Inc.

APMU has, since its founding in late 1993, worked to protect, advance, and communicate the interests and concerns of Priority Mail users, and to promote improvements

Lori Ware
President
(Amway Corporation)

Jon Wittnebel
Vice President
(CTC Distribution Services, LLC)

Ernie Brogdon
Treasurer
(Intuit Inc.)

Joyce Bagby
Secretary
(RJ Reynolds Tobacco Co.)

William J. Olson
Legal Counsel

John Haldi
Economic Counsel

in the performance and value of Priority Mail. APMU is the only consolidated voice of Priority Mail users in the mailing community.

APMU intervened as an active participant in the last two omnibus rate cases before the Postal Rate Commission (Docket Nos. R97-1 and R94-1), as well as several mail classification cases (Docket Nos. MC95-1, MC96-1, and MC97-2). APMU also represents Priority Mail users on the Mailers Technical Advisory Committee (MTAC), and publishes a bimonthly newsletter, *APMU News*.

APMU is concerned about the possible effects of the proposed legislation not only on Priority Mail, but also on the long-term success of the other competitive products.

Priority Mail

Since enactment of the Postal Reorganization Act of 1971, Priority Mail has grown to become one of the Postal Service's most successful products. Between 1972 and 1998, Priority Mail volume grew 460.3 percent (from 208 million pieces in FY 1972 to 1.2 billion pieces in FY 1998), while the Postal Service's revenue from Priority Mail grew 1,075 percent (from \$353 million in FY 1972 to \$4.1 billion in FY 1998).

Further, Priority Mail now makes a hefty contribution to institutional costs. The FY 1997 operating profit (*i.e.*, contribution to institutional costs) of Priority Mail was \$1,975.8 million. One result of the sustained growth in Priority Mail is that its **operating profit** in FY 1997 was almost 5.6 times its **entire revenue** in FY 1972. The operating profit from Priority Mail was also 6.5 times greater than the operating profit of **all** Periodicals and **all** Standard B mail, **combined**. Viewed differently, the operating profit from Priority Mail exceeded the

combined operating profit of all domestic and international postal classes of mail and special services combined, excepting First-Class Mail and Standard A Mail.

Competitive Products

Of the "competitive" basket of products (Priority Mail, Express Mail, Mailgrams, and certain categories of Parcel Post and International Mail), Priority Mail contributes by far the greatest share to institutional costs (according to the projection of Test Year 1998 after rates in Schedule 1, Appendix G of the Commission's *Op. & Rec. Dec.* in Docket No. R97-1). This is shown in Table 1, below. (Single-piece international mail and single-piece parcel post would be treated as non-competitive products under H.R. 22, but a breakout of data for these categories is not available to us.)

Table 1
Competitive Products
Revenue and Contribution to Institutional Costs
(Test Year 1998 After Rates)

	Revenue (\$ 000)	Distribution (%)	Contribution to Institutional Costs (\$ 000)	Distribution (%)
1. Priority Mail	\$4,019,575	55.5%	\$1,599,968	76.6%
2. International Mail	1,643,844	22.7%	331,464	15.9%
3. Express Mail	829,118	11.5%	99,059	4.7%
4. Parcel Post	740,510	10.2%	54,600	2.6%
5. Mailgrams	<u>4,680</u>	<u>0.1%</u>	<u>4,113</u>	<u>0.2%</u>
TOTAL	\$7,237,727	100.0%	\$2,089,204	100.0%

As Table 1 shows, according to the Commission's Docket No. R97-1 projections, among the competitive products, the contribution to institutional costs by Priority Mail (76.6

percent) is disproportionately high, compared to its revenues (55.5 percent). Consequently, Priority Mail will bear the greatest burden of any rate floor imposed on competitive products as a whole, such as the requirement that the competitive products have a collective cost-coverage ratio which is equal to or greater than the collective cost-coverage ratio for all products. Currently, again using the Commission's Docket No. R97-1 Test Year After Rates data projections, the collective cost-coverage ratio for competitive products is 1.41, and the collective cost-coverage ratio for all products is 1.56. In order to comply with the equal cost-coverage provision, the competitive products would have to contribute an additional \$794 million to institutional costs. The rate impact if the additional contribution is distributed in proportion to the existing contribution is set out in Table 2, with Priority Mail showing a staggering 58 cent average per-piece rate increase:

Table 2
Competitive Products Cost-coverage Shortfall
Distributed By Current Contribution

	Additional Contribution (000)	Percentage Rate Increase	Increase per piece
Priority Mail	\$608,183	15 percent	\$0.58
International Mail	\$126,241	8 percent	\$0.13
Express Mail	\$ 37,317	5 percent	\$0.64
Parcel Post	\$ 20,643	3 percent	\$0.10
Mailgrams	\$ 1,588	34 percent	\$0.33

Of course, Table 2 does not take into account the effect that such large rate increases would have on volume. Reductions in volume would need to be offset by even higher rate increases.

The Postal Service's competitive products are relatively demand-elastic, and lag behind their private counterparts in competitive features such as delivery confirmation with track-and-trace, insurance, and highly reliable delivery performance and guaranteed delivery, so their positions in their respective markets are quite precarious. Priority Mail's growth has in recent years trailed that of its competition, losing market share, and Priority Mail cannot sustain a large rate increase.

APMU recognizes the desire to ensure that the coverage on products which face outside competition not be set so low that the burden of institutional costs falls exclusively on monopoly or noncompetitive products, but the equal contribution provision of HR 22 would not accomplish this, even with the addition of much-needed flexibility provided in the substitute amendment to the bill. The unintended consequence of the equal contribution provision in the long run, even with the limited authority the Postal Regulatory Commission would have under the substitute version of the bill, would be to price the Postal Service out of these competitive markets and to place greater burdens on monopoly and other captive mailers. Indeed, this is undoubtedly what some supporters of the provision, including those who compete with Priority Mail, have in mind.

The cost-coverage requirement places too much formalistic emphasis on cost-coverage ratios as a measure of the fairness of the rate schedule as between competitive and noncompetitive products. The emphasis should be placed on preserving and increasing **total contribution to institutional costs** from the competitive basket of products. The volume of Priority Mail has consistently grown much faster than that of any other major product, as has Priority Mail's contribution to institutional costs. It better serves long-term stability to realize

moderate per-piece profits from greater volume than to realize greater per-piece profits from a smaller, perhaps declining volume base.

The measure of fairness in rate design should not be restricted solely to a comparison of cost-coverage ratios. For example, in the most recent rate case before the Postal Rate Commission, Docket No. R97-1, the Commission's rate design established a collective cost-coverage ratio for "competitive" products of 1.41, and a collective cost-coverage ratio for all products of 1.56.¹ At the same time, while competitive products as a whole cover nearly 10 percent of the Postal Service's institutional costs, they only amount to only 1.2 percent of Postal Service volume. Viewed another way, competitive products contribute \$0.891 per piece, over eight times the overall average per-piece contribution of \$0.108. This is especially the case for Priority Mail, which has borne an increasing share of the burden of institutional costs, as shown by Table 3, below.

¹ Please note that since, by current law, all Postal Service products must cover their own costs, the noncompetitive products can not be said to be "subsidizing" the competitive products.

Table 3
Contribution to Institutional Costs By First-Class and Priority Mail
(Test Year 1998 After Rates)

PRC Docket No.	Contribution to Institutional Costs at Commission's Rates (\$, 000)			Share of Contribution to Institutional Cost		Source (6)
	First-Class Letters (1)	Priority Mail (2)	Sum (3)	First- Class Letters (4)	Priority Mail (5)	
R97-1	14,044,293	1,599,968	15,644,261	89.77%	10.23%	App. G, Sc.1
R94-1	13,436,327	1,361,712	14,798,039	90.80%	9.20%	App. G, Sc.1
R90-1	10,524,359	858,677	11,383,036	92.46%	7.54%	App. G, Sc.1
R87-1	8,192,558	543,262	8,735,820	93.78%	6.22%	App. G, Sc.1
R84-1	5,949,439	481,715	6,431,154	92.51%	7.49%	App. G, Sc.1

Further, the cost-coverage requirement in combination with the rate cap on noncompetitive products would inevitably serve as a strict rate floor for the competitive products. The rate cap on noncompetitive products could severely limit the contribution to institutional costs by noncompetitive products, and the remainder of institutional costs would have to be met by the competitive products. As discussed above, the requirement for a minimum overall competitive cost-coverage eventually could cause the collapse of competitive product volume and thereby the collapse of total competitive product contribution to institutional costs. The shortfall in institutional costs would then have to be met by the noncompetitive products, which would likely necessitate rate increases for noncompetitive products that exceed the rate cap provision. Therefore, the cost-coverage and rate cap provisions would inevitably conflict. Both should not be enacted as written.

An Alternative Approach

Although we understand that the minimum markup requirement is considered by some to be one of the important safeguards in the Postal Modernization Act of 1999, we have attempted to arrive at an alternative approach. We have not had the opportunity to conduct a full study of this approach, but nonetheless offer it now subject to further examination.

As is shown in Table 1, above, the competitive classes of mail currently contribute approximately \$2.1 billion to the institutional costs of the Postal Service. This \$2.1 billion represents 9.7 percent of the Postal Service's total institutional costs of \$21.6 billion. Although the contribution requirement included in the current version of H.R. 22 would have the power to prevent the competitive classes' contribution to institutional costs from decreasing due to through an "unfair" rate cut to a competitive class (a largely groundless fear of the Postal Service's competitors), it would not have the power to prevent decreases in contribution to institutional costs due to a dramatic loss of volume caused by a staggering rate increase.

An alternative, which advances the same purposes as the current version of H.R. 22, but without the unintended consequences described above, could be to establish a floor on the total contribution to institutional costs from the competitive classes, expressed both as an absolute dollar amount (currently \$2.1 billion) and as a percentage of total institutional costs (currently 9.7 percent), whichever results in the greater contribution. Initially, the floor could be determined during the baseline rate case, and thereafter reviewed annually by the Postal Regulatory Commission and adjusted whenever the level of institutional costs has changed, whenever an existing noncompetitive product is transferred between the competitive and

noncompetitive categories, or whenever the demand for the competitive products changes significantly.

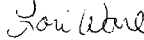
Conclusion

If Priority Mail and the other competitive products are to remain as significant contributors to the success of the Postal Service, the Postal Service should not be required to achieve legislatively-required markups from the competitive products, at the expense of achieving maximum profits from the competitive products.

If the minimum markup provision remains in the bill as written, APMU must go on record opposing what will have a disastrous effect on the Postal Service's most successful product.

If APMU can be of any further assistance to you or your staff, please do not hesitate to contact us.

Sincerely yours,


Lori Ware
President

cc: Rep. Chaka Fattah
Rep. Benjamin Gilman
Rep. Mark Sanford
Rep. Steven LaTourette
Rep. Dan Miller
Rep. Major Owens
Rep. Danny Davis