

MINUTES

Time: 2:00 pm EST

Date: May 28, 2003

Location: Hart Senate Office Building
Washington, DC

Members in Attendance: Co-Chairs James A. Johnson and Harry J. Pearce, Commissioners Dionel Aviles, Don V. Cogman, Carolyn Gallagher, Norman Seabrook, Robert Walker, and Joseph Wright.

Staff in Attendance: Executive Director Dennis Shea, Randall Lewis, Jana Sinclair White, James Cox, and Paul Revesz.

Agency Employees in Attendance: Designated Federal Official Roger Kodat.

Members of the Public Providing Oral or Written Statements: Timothy Ryan, Managing Director, JP Morgan Chase; Winthrop Watson, Managing Director, JP Morgan Chase; Professor Michael Bradley, Department of Economics, George Washington University; James Holsen, Vice President, Industrial Engineering, United Parcel Service; Tom O. S. Rand, Aon Consulting; The Honorable William L. Clay, Sr., Chairman, Consumer Alliance for Postal Services; Jim Martin, President, 60 Plus Association; Gary Mulloy, Chairman and Chief Executive Officer, ADVO; James R. O'Brien, Director of Distribution and Postal Affairs, Time Inc.; Max Heath, Postal Committee Chairman, National Newspaper Association; Guy H. Wendler, President and Chief Executive Officer, Stamats Communications Inc., on behalf of American Business Media; Brad Nathan, President, Quebecor Logistics.

Matters Discussed:

Co-Chair Harry J. Pearce called the meeting to order at 2 pm. Mr. Pearce thanked Senator Susan Collins, chair of the Senate Governmental Affairs Committee, for securing the meeting room. Mr. Pearce stated that the Commission had completed the "field hearing" portion of its work with meetings in Austin, Los Angeles, and Chicago and then briefly discussed the topic of each of these previous meetings. He noted that today's meeting was different from the field hearings in that it will cover a number of disparate topics. Mr. Pearce further noted that the Commission has heard the testimony of nearly 70 individuals in its previous five meetings. He thanked the witnesses who have already appeared before the Commission and those who will testify during the next two Committee meetings. The meeting continued with remarks by Co-Chair James A. Johnson.

Mr. Johnson discussed the agenda for the meeting and reviewed each panel of witnesses. He also thanked Senator Susan Collins for her help in obtaining the use of the room. In addition,

Mr. Johnson expressed his gratitude to the witnesses who will appear before the Commission today. Mr. Johnson then briefly outlined the agenda for the Commission meeting on May 29, 2003.

Panel One: The Financial Outlook for the Postal Service

Testifying on this panel was Winthrop Watson and Timothy Ryan. Please see attachment A for their prepared written comments.

Questions for Mr. Watson: Mr. Ryan and Mr. Watson jointly provided testimony on behalf of JP Morgan Chase. When asked what his assessment would be of a publicly traded corporation with business challenges similar to those facing the Postal Service, Mr. Watson responded that he would be concerned about that company's future financial health. He further stated that a private corporation has flexibility within the marketplace, whereas the Postal Service does not. He noted that if mail volume declines, the current regulatory structure does not provide necessary flexibility. In response to questions concerning the amount of flexibility the Postal Service should have, Mr. Ryan said that the Postal Service Board of Governors (Board) and management should have the flexibility to respond rapidly to business challenges it faces. When asked to talk about the interaction between flexibility and regulation, Mr. Ryan stated that the Postal Service Board has more authority than the Boards of some highly regulated financial institutions. He also stated that given the size of the Postal Service there must be some regulatory control. When asked whether the Postal Service should be allowed to retain earnings, Mr. Watson stated that retained earnings would provide a financial cushion for the Postal Service.

In response to questions concerning the real estate assets of the Postal Service, Mr. Watson stated that the book value of the Postal Service's real estate is approximately \$15 billion, but that the market value is probably higher. In response to questions concerning the Postal Service's mission, Mr. Watson stated that the Postal Service has told JP Morgan Chase that its mission is a balancing act between providing universal service and providing reasonable rates. When asked how he would reduce costs, Mr. Watson stated that JP Morgan Chase has not spent a lot of time on the operational side of the Postal Service. In response to questions concerning the fees the Postal Service pays JP Morgan Chase, Mr. Ryan stated that it has a contract with the Postal Service worth approximately \$3 million and that it also receives fees for projects that fall outside the scope of the contract.

Panel Two: Cost Measurement, Attribution, and Pricing

Testifying on this panel were Michael Bradley and James Holsen. Please see attachments B and C for their prepared written comments.

Questions for Mr. Bradley: When asked how the Postal Service could ensure that First Class Mail is not cross-subsidizing competitive products when it can only attribute 58% of its costs, Mr. Bradley stated that the Postal Service could ensure there is no cross-

subsidization by considering the incremental costs of competitive products and ensuring that stand alone costs are covered by monopoly products. Mr. Bradley agreed that the Postal Service should maximize to the greatest extent possible its understanding of its “causative” costs. When asked whether the Postal Service should attribute 90% of its costs if it had the ability to do so, Mr. Bradley stated that one should do proper causative analysis without regard to reaching a specific numerical goal. When asked whether he had compared the Postal Service’s cost attribution practices to posts in any countries other than Canada, he responded that he had not. He further stated that some European countries require full cost attribution, but that he believes the results are arbitrary. Mr. Bradley responded to Mr. Holsen’s contention that costs could be attributed objectively by stating that the difference between the Postal Service and the United Parcel Service (UPS) is that the Postal Service allows for the possibility that there is not a proportional relationship between volume and costs. He stated that the Postal Service has found that time does not increase by 5% if it adds 5% more volume to a carrier’s day. As a result, Mr. Bradley asserted, the Postal Service has economies of scale and scope and that the attribution of 100% of costs is inappropriate when these are present. He also stated that there are cases where UPS makes arbitrary decisions.

Questions for Mr. Holsen: When asked whether he agrees with Mr. Bradley’s testimony that the Postal Service cannot improve on its 58% attribution of costs, Mr. Holsen stated that all businesses should be able to track their costs. He agreed that attributing costs would be a challenge for the Postal Service, but stated that it is doable. He further stated that the concepts for attributing costs are the same whether you deliver to 140 million addresses or 7 million addresses. He also stated that cost attribution is mandatory in the private sector. In response to questions concerning the method UPS uses to attribute costs, Mr. Holsen stated that UPS attributes 100% of its costs. He further stated that UPS makes a “Herculean” attempt to attribute costs without using subjective judgments and that cost attribution can be conducted with objectivity. He stated that UPS uses whatever variable is driving costs in a given circumstance. When asked how costing mechanisms affect pricing decisions, Mr. Holsen stated that every UPS product is developed with the intent of operating with a minimum amount of profit and that the price of a product is not allowed to fall below the limit that would achieve that profit. When asked what he would do to turn the Postal Service around within one year without touching labor agreements currently in place, Mr. Holsen responded that he would try to determine where the costs are, would not assume that anything is a “sacred cow,” would develop uniform standards and methods, and would develop incentives for employees to do tasks correctly. With regard to uniform standards and methods, Mr. Holsen noted that UPS uses the same delivery methods in all countries in which it operates. With regard to employee incentives, he noted that UPS employees receive daily cash benefits based on delivery standards and that 15% of profits are redistributed to UPS managers each year in the form of stock compensation.

Panel Three: Postal Service Benefits Package

Testifying on this panel was Tom O. S. Rand. Please see attachment D for his prepared written comments.

Questions for Mr. Rand: When asked how a compensation premium, if one exists, could be corrected within a collective bargaining environment, Mr. Rand stated that it must be corrected over time incrementally. He stated that the Postal Service's approach to correcting the benefits portion of the compensation premium has been to focus on changing the allocation of health care premium fees between the Postal Service and its employees. He thinks a more preferable approach to achieve comparability would be for the Postal Service to continue to participate in the Federal Employees Health Benefits Plan (FEHB), but to bargain over more features of the plan. He noted the tension between the Postal Reorganization Act (PRA) mandate to provide comparable benefits to the private sector and to maintain the benefits provided [immediately] prior to [July 1,] 1971. In response to questions concerning his presentation, Mr. Rand clarified that because 75% of the benefits package is directly linked to pay, a reduction in wages also transfers to a reduction in the cost of the benefits package. He also stated that he believes wages and health benefits are equally important components of the compensation premium. When asked how much management salaries contribute to the cost of running the Postal Service, Mr. Rand stated that the costs are not material in that there are approximately 10,000 executive management employees and they are subject to a statutory salary cap.

Panel Four: Views of the Stakeholders

Testifying on this panel were William L. Clay, Sr., Jim Martin, Gary Mulloy, James R. O'Brien, Max Heath, Guy H. Wendler, and Brad Nathan. Please see attachments E, F, G, H, I, J, and K for their prepared written comments.

Questions for Mr. Clay: When asked to define universal service, Mr. Clay stated that is dependable delivery of mail products, including parcels weighing up to 70 pounds, to every address in the country, six days a week, at uniform rates. He further stated that providing mail services is a government service as important as providing education and national defense. When asked whether he supported worksharing discounts, Mr. Clay stated the evidence he has seen suggests that worksharing discounts do not generate cost savings. He elaborated that he is not opposed to discounts, but to excessive discounts. He further stated that worksharing discounts passed through to customers equal 125% of costs saved by the Postal Service and cited testimony before the Postal Rate Commission on January 9, 2003 as authority for his assertion. He stated that the Postal Service should know what is driving its costs before it makes decisions regarding worksharing discounts. In response to questions regarding Congressional oversight, Mr. Clay stated that there should be a full Congressional Committee with oversight of the Postal Service. He further stated that he believed the Postal Service is providing the best possible service today for the cost.

Questions for Mr. Martin: When asked how important it is to seniors for the Postal Service to provide expedited mail services, Mr. Martin stated that seniors would pay a price to get quality service. He noted recent concerns that the Postal Service is not

delivering expedited mail in the time promised by the Postal Service's advertising campaign.

Questions for Mr. Mulloy: In response to questions concerning cost attribution, Mr. Mulloy stated that a fair and objective assessment of costs is an important step for the Postal Service to take. He stated that activity based costing uses a lot of subjectivity. He further stated that the Postal Service should develop a pricing strategy that reflects a business's obligation to grow revenue. He asserted that the current pricing strategy does not allow management to strategize its approach. He stated that ADVOC would like to pay rates based on the services it uses. In response to questions concerning growth potential for the Postal Service, Mr. Mulloy stated that the Postal Service is an underutilized asset in the retail advertising arena. In response to questions concerning the regulatory structure of the Postal Service, Mr. Mulloy stated that the structure should allow Postal Service management to develop volume-based contracts with large customers within set boundaries.

Questions for Mr. O'Brien: In response to questions concerning cost attribution, Mr. O'Brien stated that there is data to suggest that each mail class covers its attributable costs and makes a contribution to overhead, but asserted that the Postal Service does not use the data to create cost-based rates. He further stated that if the rates were cost based, mailers would choose the most cost effective means to deliver products and would drive costs out of the Postal Service.

Questions for Max Heath: Mr. Heath did not receive any questions.

Questions for Guy H. Wendler: When asked what incremental changes are needed in the rate-making process, Mr. Wendler stated that the Postal Service needs flexibility to manage its cost infrastructure. He stated that a review of facilities is necessary and that the Postal Service should be allowed to close facilities. He suggested that the Commission consider recommending a facility closure process modeled on the Defense Base Closure and Realignment Act.

Questions for Brad Nathan: In response to questions concerning logistics costs, Mr. Nathan stated that Quebecor is an advocate of the Postal Service understanding its logistics costs on a detailed level. When asked about fairness for small mailers, Mr. Nathan responded that he is concerned that small mailers will not get fair treatment in the future and asserted that that Postal Rate Commission (PRC) should be given subpoena power. He also stated that Quebecor is not opposed to volume discounts if discounts are truly correlated to costs, but noted concerns regarding the accuracy of Postal Service costing methods.

Commission Business

Harry Pearce announced that the Commission meeting on May 29, 2003 would begin at 8:30 am and that there would be a period for audience comments at the end of the meeting. The meeting adjourned at approximately 5:30 pm EST.