



Testimony of
The Honorable Dan G. Blair, Chairman
On behalf of the
Postal Regulatory Commission
Before the
U.S. House of Representatives
Committee on Oversight
And Government Reform
Subcommittee on Federal Workforce,
Postal Service, and the District of Columbia

October 30, 2007

Postal Regulatory Commission Chairman Dan Blair
Statement before the House Subcommittee on Federal Workforce,
the Postal Service, and the District of Columbia
October 30, 2007

Chairman Davis, Ranking Member Marchant, and members of the Subcommittee, thank you for inviting me to testify today. I appreciate the opportunity to discuss with you the Postal Regulatory Commission's Recommended Decision to the Postal Governors on the R2006-1 rate case.

Before doing so, however, I am pleased to report that yesterday afternoon the Commission issued its final order establishing regulations governing the modern ratemaking systems for market dominant and competitive products. The rules are posted on our website and have been submitted to the Federal Register for publication. My fellow Commissioners and I are extremely proud to have completed this essential and critical requirement of the Postal Accountability and Enhancement Act (PAEA) eight months ahead of the statutory deadline. On behalf of the Commissioners, I thank all who participated in shaping these regulations – commenters, witnesses at our field hearings, the Postal Service, and most importantly, the Commission's hardworking staff.

Having these new regulations in place allows everyone whose lives are touched by the U.S. Mail to move squarely into the flexible environment offered by the PAEA. These rules provide the Postal Service with the ability to adjust rates immediately for market dominant products, such as those under discussion today, within a Consumer Price Index (CPI) cap. The Postal Service now has the tools to balance their near term needs with future goals.

No longer will the Postal Service be constrained by the old cost of service regime. I am hopeful that the early release of these regulations will obviate the need for one last omnibus rate case under the 1970 law. Transitioning now into this new ratemaking system will let the Commission and the Postal Service devote our resources to other mandates of the PAEA, including service standards and service performance goals.

Let me now turn to the subject of today's hearing – the rates recommended by the Commission and approved by the Postal Governors. First, it is important to understand that the last omnibus rate case, Docket No. R2006-1, was the first fully litigated case since 2000. It was preceded by two settled cases, which provided the Postal Service with needed revenue, but did not address growing costing imbalances, operational concerns, or the Postal Service's long-term interest in moving to shaped-based pricing because of the negotiated nature of these settled cases.

As background, in May 2006, the Postal Service filed a request with the Commission for a recommended decision on proposed changes in postage rates. Between the time of this filing and our decision on February 26, 2007 – when we sent our recommended decision to the Postal Governors – 60 parties participated in open hearings and public comment periods before the Commission. We reviewed 139 submissions of testimony from 99 witnesses. In fact, most of the witnesses to appear before the Subcommittee today participated in our proceedings either individually or through their business associations. Three weeks later, on March 19, 2007, the Governors adopted the Commission's rate recommendations with three limited exceptions: the rate for the Priority Mail Flat Rate Box, the First-Class Mail nonmachinable letter surcharge, and rates for Standard Mail flats.

Understanding that the rates recommended by the Commission to the Governors in this past rate case were based on the 1970 law is significant. We were guided by the principles that:

- Rate differences should reflect cost differences;
- Rates should be based on paying for what you use;
- Rates should generate efficient mail streams that help control costs and keep postage rates reasonable; and
- Rates should be fair and equitable.

For example, costs for First-Class and Standard Mail letters have remained essentially flat over the past 10 years and as a result, the rates for that mail have been fairly stable. This is in sharp contrast to the spiraling costs associated with the handling of Periodicals. For many years, the Commission has sought to keep Periodicals postage rates as low as possible in the face of declining magazine mail volume and increasing Postal Service handling costs. The cost inefficiencies inherent with Periodicals were not new, and the Commission, the Postal Service, and mailers have sought alternatives for years to deal with these rising costs and declining

volumes. Despite increased incentives and cost reduction programs, little progress was made in restraining Periodicals cost increases.

Both mailers and the Postal Service have pushed the Commission to resolve this problem. By the late 1990s, it became apparent that the rate structure for Periodicals needed to recognize better the cost drivers contributing to the spiraling costs of processing this class of mail.

Knowing that magazines make the lowest contribution to overhead of any class of mail – roughly \$3.6 million to fund almost \$35 billion in overhead costs – was a factor in our recommending a rate structure based on paying for what you use, that will encourage better operational practices, and help eliminate unnecessary costs. This new rate structure has evolved over time through the Commission's open and transparent ratemaking and complaint process. The five Commissioners were unanimous in their support for a refinement of Periodicals rates, which we believe will stem the tide of rising costs for a class of mail whose revenue falls far short of supporting its costs to the Postal Service.

The Commission's decision was grounded in the need to balance any new rate structure with our long-standing principle of promoting the free flow of ideas. This principle would be compromised should this class of mail become unsustainable due to rising costs and declining volume. We believe this principle is firmly embedded in our decision. Our recommended decision continues to preserve and foster the continued widespread dissemination of political and cultural thought.

In our recommended decision, we increased the editorial discount available to all magazine mailers. In fact, under our approach – and based on the sampling of publications information provided by the Postal Service during the rate case – we found that our recommendation allowed small publications, those with circulations of 15,000 or less, lower increases than under proposals made by the Postal Service or large magazine interests. The Commission exercised its discretion by increasing the editorial discount, protecting the smallest publications, and minimizing the institutional cost burden for all magazine mailers.

Another area of interest to the Subcommittee is the Commission's decision on Standard Regular flats. As with Periodicals, the Commission's recommendation was based on evidence developed in open administrative proceedings, in which all interested parties had ample opportunity to intervene. Our decision properly relied solely on the evidence presented.

In its previous rate decision, the Commission emphasized its concern that because of two consecutive settled rate cases, the misalignment of rates and costs in Standard Mail was getting worse. We warned the postal community that the upper bounds of "normal" rate increases might have to be extended in the next case to allow for the re-alignment of rates with costs. In R2006-1, the Presiding Officer issued an information request focused on whether cost differentials justified proposed rate differentials, and the Commission issued two Notices of Inquiry asking the postal community to provide comments on how to design rates that would best align rates with costs, especially, shape-based cost differences. The Commission was open to all suggestions, but in the end, the principle of productive efficiency overwhelmingly dictated that, to the extent practicable, rate differences should reflect cost differences within a product line like Standard Regular mail. No party to R2006-1 should have been surprised that the rates recommended by the Commission began to move toward this goal.

The Postal Governors asked the Commission to reconsider its recommendations in three areas, including Standard Regular flats. On March 29, 2007, the Commission issued an Order establishing procedures for further consideration of these issues and invited public comments from interested parties. On April 27, 2007, the Commission recommended to the Governors that the rate for the Priority Mail Flat Rate Box be lowered and that letter-shaped First-Class Mail nonmachinable surcharge be expanded. The Governors accepted these recommendations. We also issued a separate Order granting late notice of intervention filed by the Coalition of Catalog Mailers allowing this party to intervene in the reconsideration of the Commission's recommendations on Standard Regular flats.

On May 25, 2007, we issued a Second Opinion and Recommended Decision on Reconsideration which recommended a transitional, temporary rate reduction of three cents (\$0.03) for all Standard Mail Regular flats and two cents (\$0.02) for Standard Regular Nonprofit flats to address concerns raised by the Governors. The difference between Standard Mail Regular flats and Standard Regular Nonprofit flats is due to a 2000 law that sets the average revenue per piece for nonprofit mail at 60 percent of the average revenue for commercial mail.

The Commission's May 25, 2007, proposal was rejected by the Governors. Our recommendation would have accomplished several goals, including leaving Standard letter rates untouched while allowing the Postal Service's projected revenues to meet expected costs. In addition, the Commission's proposal would have provided mailers with additional time to adjust to the higher new rates, just as with the new Periodicals rates that went into effect two months after the general rate increases. We were also mindful that a number of those who commented on the issue, strongly argued that it would be improper to shift the financial burden associated with lowering catalog and flats rates to other, less costly-to-process mail. The Commission agreed unanimously with that concern.

In summary, the Commission believes its recommended rates under the R2006-1 decision provide the foundation for future rate setting under the CPI-based ratemaking system required by the PAEA. With the new ratemaking systems in place early, the Commission is providing the Postal Service with the means to adjust rates quickly in light of changes occurring in the industry, as well as adjustments to meet financial needs. We look forward to working with Members of Congress and the Postal Service to ensure that this new law benefits both individual mailers and business mailers.

Thank you again for the opportunity to appear today before the Subcommittee, and I look forward to responding to your questions.