



September 13, 2005

Honorable Tom Davis
Chairman
Committee on Government Reform
House of Representatives
Washington, DC 20515-6143

Dear Mr. Chairman:

The United States Postal Service has sought postal reform legislation for more than a decade for one simple reason: to assure affordable, universal mail service to the American public long into the future. Over that period, it has become increasingly clear that new communications technology and robust growth in the package and document delivery market would require changes to our operating charter – providing increased flexibility and accountability – to support our important mission.

We are pleased that you share this viewpoint and are grateful for your untiring efforts to advance necessary reform. We also understand that the legislative process, by its very nature, involves balancing the needs and concerns of a wide range of interests. As Governors of the organization that will be charged with the overall implementation of reform legislation, however, we feel it would be beneficial to once again clarify our position on several issues that bear further consideration.

The Postal Service has made extraordinary efforts, and experienced extraordinary success, in operating within the confines of current law. We continue to achieve new heights of service performance and customer satisfaction. We have reduced debt dramatically and virtually eliminated interest payments. We have achieved an unprecedented five consecutive years of growth in total factor productivity – resulting in cost savings of more than \$1 billion each year. We have reduced career staffing from its peak in 1999 to pre-1985 levels, without layoffs. In short, we are doing everything we can to manage as effectively as possible within the constraints of an obsolete business model.

Our recent success should not be perceived as an indication that we do not face significant and increasing challenges that call for difficult and stringent solutions. Since 2000, First-Class Mail volume, which provides the highest contribution to our system overhead, has declined by 5.4 percent, almost 5.6 billion pieces. Over the same period, advertising mail volume has grown 6.1 percent. There is not a simple piece-to-piece correspondence as First-Class Mail declines and advertising mail grows, however. It takes nearly three pieces of advertising mail to generate the same contribution as one piece of First-Class Mail. As a financial proposition, we simply do not believe that growth in advertising mail will offset the decline in First-Class Mail. At the same time, we are facing steadily growing network expansion costs to accommodate the growth in deliveries by about 1.8 million new addresses a year. From our perspective, it is clear that we are facing a growing gap between revenue and costs.

Our greatest fear is that, unchecked by appropriate legislative change, this will result in a cycle of rising rates that drive even greater – and quicker – volume erosion, adversely affecting service levels and the long-term viability of an affordable postal system in the United States. This would create the risk of turning back the clock by returning to the days of subsidized postal operations, placing an unwanted and unneeded burden on every American taxpayer. Our concerns about reform legislation are offered in a cooperative spirit with the intention of improving the legislation to maintain a self-sufficient, universal, and affordable national postal system.

Our primary concern is the issue of governance -- that is, the role of the regulator versus that of the Board of Governors. We believe the appropriate focus of the regulator should be oversight of Postal rates (to make sure they are not too high, too low, or discriminatory). The Board's role should be to oversee the business of the Postal Service.

While the legislation was intended to avoid extended rate litigation, both bills create a process that would permit the regulator to hear complaints at any time and on virtually any aspect of postal operations. The Postal Service would be required to take action as directed by the regulator as a result of those complaints. We are concerned that this would have the practical effect of undermining the authority of the Board and, at the same time, create the potential for constant litigation over rates and other issues. We believe that clarity in the roles of the two bodies would assure accountability and success. In the interests of efficiency and a clear separation of roles, the complaint process should be consistent with current law and be limited to rates and service issues. This would reduce regulation and red tape, and support our shared interest in providing efficient Postal services for the American people.

The Board's responsibilities include operational and financial performance. To exercise that responsibility, the Board must have authority over capital investments, purchasing, accounting, cost attribution, compensation, and the setting of goals.

There are significant public policy issues implicit in any changes in the definition of universal service, including any potential changes in the frequency of delivery. For this reason, consistent with current law, we believe that the Board, in conjunction with Congress as the elected representatives of the people, should have the final authority regarding service standards.

The Board currently has the final authority on rates. The legislation shifts that authority to the regulator. Assuming that the other governance issues raised in this letter are addressed, it is proper that the regulator would assure compliance with any rate cap and with the correct application of any rate exigency provisions. Similarly, the regulator should have the authority to prevent rate predation. The Board, of course, is vigilant and will remain vigilant in this respect. The regulator, too, should be granted subpoena authority to guarantee transparency and compliance with appropriate and applicable SEC requirements.

The actions of the regulator, growing from the powers it is given and the powers it will exercise, can have a significant and positive influence on the effective operation of the Postal Service. Yet, we are concerned that as currently constructed, the bills could lead to unintended consequences with just the opposite effect. For example, there is broad understanding that the continued efficiencies will require the Postal Service to streamline its network and facility infrastructure. As we adjust our networks, there will inevitably be minor adjustments to service standards. Our analysis of the bills suggests that the regulator would have great latitude in overseeing service standards and, potentially, intervene in decisions regarding the network. This additional layer of decision making could slow down or delay needed network innovation. The Board should retain the authority to manage these areas. The President's Commission understood these issues and recommended that the Postal Service have significant discretion to modernize the network without the need to seek regulator permission. We strongly agree with the President's Commission in this area.

Beyond the issues of governance, it is critical that reform produce a streamlined ratemaking process that ensures customers rates that are both predictable and at the lowest possible level. A key provision in both reform bills is a rate cap tied to the Consumer Price Index. The Postal Service's commitment to a CPI rate cap, applied at the class level, was made with the understanding that the exigent rate case standard would be "reasonable and necessary," rather than "unexpected and extraordinary." With that understanding, we would certainly accept a "hard" rate cap, but with the caveat that the Postal Service be given significantly greater ability to control its infrastructure and growing labor costs.

The Postal Service is already challenged to meet cost increases that exceed the rate of inflation – at a time when high-contribution First-Class Mail is declining. These increases include health benefits for current and retired employees, escalating fuel costs, and the additional resources necessary to serve a delivery base that expands by almost two million new addresses each year. If the exigency standard is established as beyond “reasonable and necessary,” the implementation of a hard rate cap could result in extensive downsizing of our operations and services.

As we consider proposed changes to the ratemaking process, it is also our belief that the Postal Service should initiate a final, omnibus rate case under the current rules of the Postal Rate Commission, with metrics similar to the case now pending. If the Postal Service is unable to recover certain increases in costs experienced since the last omnibus case, it would be at a significant deficit when moving into a price-cap regime.

It has been suggested that the Postal Service borrow funds to mitigate or preclude rate increases before a price-cap system is implemented. We do not believe this serves our ratepayers in the long term. Over the past several years, we have virtually eliminated debt. The Postal Service and, more importantly, our customers are reaping the financial benefits of significantly reduced interest expenses. Our forecasts assume that a CPI rate cap would see borrowing increase indefinitely, placing us on a slippery slope which would best be avoided.

In another area of rates, we believe the “fair and equitable” language governing rate relationships should remain a factor and not be elevated to an objective. This would prevent the unfortunate consequence of “freezing” all rate relationships, regardless of differences that could emerge in the structure of costs for different products and services.

We believe that the Postal Service should have the authority to enter into negotiated service agreements, with an after-the-fact review by the regulator. This would provide the Postal Service with the ability to expeditiously to assist its customers, while supporting our efforts to increase volume and revenue.

We also believe that the reform legislation should contain provisions that specifically authorize the Postal Service to offer volume discounts in the competitive products area. While we believe that the Postal Service already has this authority, the inclusion of specific authorization would ensure regulator approval and avoid protracted litigation.

As one of the largest employers in the United States, compensation and benefit issues are critical to the success of reform legislation. In this regard, we are grateful for your action in including workers' compensation reform provisions in S. 662. As you know, this is supported by the Administration and is notably absent from H.R. 22. This is an important step in helping us to control growth in costs.

We believe it would be beneficial to continue moving in this direction by adding language that incorporates the recommendation of the President's Commission that Title 39 be amended to eliminate 1005(f), which provides that no change to benefits should result in benefits that are less than those in effect on July 1, 1971. We believe that relief in this area is critical to the Postal Service's ability to better control its costs, since some 80 percent of our costs are directly attributable to compensation and benefits.

Since 2003, a new issue has taken center stage in the reform debate: the need to resolve the issue of Civil Service Retirement System (CSRS) funding related to military service of postal employees and the release of the escrow funds resulting from Public Law 108-18. The Postal Service, the entire mailing industry, and our customers, the American people, remain grateful to you and other members of the Senate and House of Representatives for your support of that legislation. It contributed greatly to our ability to extend rate stability and reduce debt. As specified in H.R. 22 and S. 662, we believe it is essential that the postal CSRS military service retirement obligation be returned to the Treasury, that the escrow requirement be abolished, and that some portion of the CSRS overcharges be used to mitigate future rate increases for our customers.

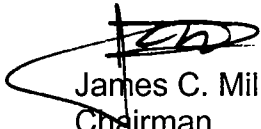
We are, of course, aware that the Statement of Administration Policy issued prior to the passage of H.R. 22 communicated that the President's Senior Advisors would recommend that he veto any enrolled bill that was not budget neutral. It is our understanding that you share our position that if budget neutrality were a key determining factor in the outcome of the legislation, the Postal Service's ability to maintain universal service at reasonable rates could well be jeopardized. If budget neutrality, along with the current deficiencies in governing flexibility, were the outcome, we have serious reservations about the continued ability of the Postal Service to maintain the level of universal service at reasonable rates currently enjoyed by the American public.

In closing, we would like to reiterate our major concerns. Both reform bills provide much needed – and appreciated – financial relief through their escrow and CSRS military provisions. However, these provisions are threatened by the Statement of Administration Policy. It is our firm belief that continued Postal Service success in an increasingly competitive market requires both increased flexibility and authority in the areas of pricing, infrastructure, and labor in order to manage our business.

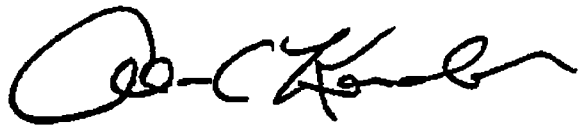
Regrettably, despite the intentions of all parties, it is our considered opinion that the bills provide neither the requisite flexibility nor the authority to accomplish our mission. While the bills would certainly provide needed financial relief, if reform legislation does not provide the Postal Service with real flexibility and authority in these areas, we would be better positioned to build on our recent progress in generating revenue and controlling costs under current law.

Again, we are most appreciative of your leadership on postal reform and we look forward to continuing our work with you on this critical issue.

Sincerely yours,



James C. Miller III
Chairman



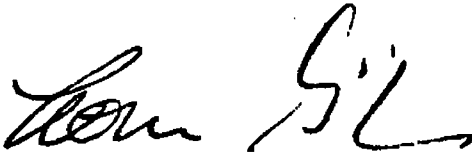
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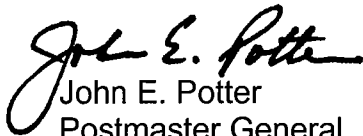
Carolyn Lewis Gallagher
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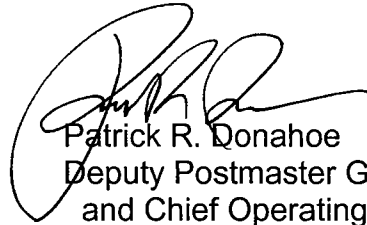
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