

THE POSTAL SERVICE: PLANNING FOR THE 21ST CENTURY

HEARING

BEFORE THE
SUBCOMMITTEE ON FEDERAL WORKFORCE,
POSTAL SERVICE, AND THE DISTRICT
OF COLUMBIA

OF THE

COMMITTEE ON OVERSIGHT
AND GOVERNMENT REFORM
HOUSE OF REPRESENTATIVES

ONE HUNDRED TENTH CONGRESS

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THE POSTAL SERVICE: PLANNING FOR THE 21ST CENTURY

THURSDAY, JULY 26, 2007

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON FEDERAL WORKFORCE, POSTAL
SERVICE, AND THE DISTRICT OF COLUMBIA,
COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM,
Washington, DC.

The subcommittee met, pursuant to notice, at 2 p.m. in room 2154, Rayburn House Office Building, Hon. Danny Davis of Illinois (chairman of the subcommittee) presiding.

Present: Representatives Davis of Illinois, Norton, Marchant, and McHugh.

Staff present: Caleb Gilcrest, professional staff member; Lori Hayman, counsel; Cecelia Morton, clerk; Ashley Buxton, intern; Ed Puccerella, minority professional staff member; Benjamin Chance, minority clerk; and Kay Lauren Miller, minority staff assistant and office manager.

Mr. DAVIS OF ILLINOIS. Welcome, Ranking Member Marchant, members of the subcommittee, hearing witnesses and all of those in attendance.

Let me welcome you to the Subcommittee on the Federal Workforce, Postal Service, and the District of Columbia hearing entitled, "The Postal Service: Planning for the 21st Century." Hearing no objection, the Chair, ranking member and subcommittee members will each have 5 minutes to make opening statements and all Members will have 3 days to submit statements for the record.

As I indicated, we are delighted that all of you are here, and I will begin the hearing.

Ranking Member Marchant, members of the subcommittee and hearing witnesses, welcome to the subcommittee's hearing on the infrastructure and realignment of the U.S. Postal Service. Today's hearing will examine the Postal Service's efforts to update outdated mail delivery standards and how it intends to realign its infrastructure through consolidating operations and closing annexes.

The Postal Service's delivery performance standards and results are central to its mission of providing reliable and efficient postal service. Standards are essential to setting realistic expectations for delivery performance and expectations. Timely and reliable reporting of performance results is essential for oversight transparency and accountability.

Mail delivery standards are important, so the Postal Service and officials can monitor the progress of mail delivery in cities like Chicago. They are working to improve mail service. The Postal Service

has informed me that based on an increased focus on mail processing and delivery performance, Chicago performance scores are showing a positive trend. The Postal Service, recognizing the importance of the timely delivery of mail, has integrated performance targets and results for some types of mail into its performance management system.

However, all mail should be subject to mail standards. A decline in first class mail due to increased competition and shifts in population demographics has resulted in the Postal Service examining ways to realign its infrastructure. I am interested in hearing how the Postal Service intends to realign its work force, processing and distribution infrastructure to address these concerns.

At the request of myself and other Members of Congress, the Government Accountability Office [GAO], has completed its report on the Postal Service's realignment efforts. The report entitled, "U.S. Postal Service: Mail Processing Realignment Efforts Underway Need Better Integration and Explanation," discusses, among other things, the need for the Postal Service to establish measurable targets to meet cost savings goals and establish criteria for selecting facilities for consolidation and realignment. The report will be released today and will contribute greatly to today's discussion.

I want to thank you all again and look forward to testimony from our witnesses.

[The prepared statement of Hon. Danny K. Davis follows:]

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**STATEMENT OF CHAIRMAN DANNY K. DAVIS AT THE
SUBCOMMITTEE ON FEDERAL WORKFORCE, POSTAL SERVICE, AND THE
DISTRICT OF COLUMBIA HEARING ON
"THE POSTAL SERVICE: PLANNING FOR THE 21ST CENTURY."**

Thursday, July 26, 2007

Ranking Member Marchant, members of the Subcommittee, and hearing witnesses, welcome to the Subcommittee's hearing on the infrastructure and realignment of the United States Postal Service (the Postal Service). Today's hearing will examine the Postal Service's efforts to update outdated mail delivery standards and how it intends to realign its infrastructure through consolidating operations and closing annexes.

The Postal Service's delivery performance standards and results are central to its mission of providing reliable and efficient postal service. Standards are essential to setting realistic expectations for delivery performance and expectations. Timely and reliable reporting of performance results is essential for oversight, transparency and accountability.

Mail delivery standards are important so the Postal Service and officials can monitor the progress of mail delivery in cities like Chicago that are working to improve mail service. The Postal Service has informed me that based on an increased focus on mail processing and delivery performance, Chicago performance scores are showing a positive trend. The Postal Service, recognizing the importance of the timely delivery of mail, has integrated performance targets and results for some types of mail into its performance management system. However, all mail should be subject to mail delivery standards.

A decline in First-Class Mail due to increased competition and shifts in population demographics has resulted in the Postal Service examining ways to realign its infrastructure. I am interested in hearing how the Postal Service intends to realign its workforce, processing and distribution infrastructure to address these concerns.

At the request of me and other Members of Congress, the Government Accountability Office (GAO) has completed its report on the Postal Service's realignment efforts. The report, entitled, "U.S. Postal Service: Mail Processing Realignment Efforts Under Way Need Better Integration and Explanation," discusses, among other things, the need for the Postal Service to establish measurable targets to meet cost savings goals and establish criteria for selecting facilities for consolidation and realignment. The report will be released today and will contribute greatly to today's discussion.

Thank you and I look forward to the testimony of today's witnesses.

Mr. DAVIS OF ILLINOIS. At this time I would like to yield to the ranking member, Mr. Marchant.

Mr. MARCHANT. Good afternoon, and thank you, Chairman Davis, for holding the hearing today about the U.S. Postal Service Infrastructure and Realignment. I understand that with any organization as large as the Postal Service, changes take time and a great effort from many diverse groups. As we continue our role on the subcommittee in providing oversight of the Postal Service, I am reminded it is not a perfect system, but one which is ever-changing and expanding. We can't expect a system which moves 213 billion pieces of mail a year to be perfect or stagnant.

With the release and enactment of postal reform legislation, as well as the current challenges faced by the Postal Service, today's Postal Service faces many more challenges than ever before. But through such challenges come opportunity.

I look forward to hearing from all of the witnesses today and learning more about the Postal Service and what it can do to maintain a viable delivery system in the 21st century. Thank you, Mr. Chairman.

Mr. DAVIS OF ILLINOIS. Thank you, Mr. Marchant.

We will now hear from our witnesses. First I would like to introduce the first panel. Panel one is Ms. Katherine Siggerud, who is Director of the Physical Infrastructure Issues Team at the Government Accountability Office [GAO]. She has directed GAO's work on postal issues for several years, including recent reports on delivery standards and performance, processing that work realignment, contracting policies, semi-postal stamps and biological threats. We welcome you.

Mr. Gordon Milbourn III was named assistant inspector general for audit of the U.S. Postal Service Office of Inspector General in February 2005. He is responsible for all audits in the Postal Service areas of cooperation, financial management, technology and headquarter operations.

If the witnesses would rise, it is the tradition of this committee to swear in all witnesses. So if you would raise your right hands. [Witnesses sworn.]

Mr. DAVIS OF ILLINOIS. The record will show that each one of the witnesses answered in the affirmative. You may be seated.

Thank you very much, and we will begin with Ms. Siggerud.

STATEMENTS OF KATHERINE A. SIGGERUD, DIRECTOR, PHYSICAL INFRASTRUCTURE ISSUES, U.S. GOVERNMENT ACCOUNTABILITY OFFICE; AND GORDON C. MILBOURN III, ASSISTANT INSPECTOR GENERAL FOR AUDIT, OFFICE OF THE INSPECTOR GENERAL, U.S. POSTAL SERVICE

STATEMENT OF KATHERINE A. SIGGERUD

Ms. SIGGERUD. Chairman Davis, Ranking Member Marchant, Mr. McHugh, thank you for your invitation to appear today at this hearing on the Postal Service and its planning for the 21st century. My remarks reflect reports we issued in 2005, 2006 and at this hearing today. On that basis, my statement will focus on first, major challenges affecting the Service's mail processing operations that have prompted the need for network realignment. Second, con-

cerns we raised in our 2005 report and today's report about the Service's efforts to realign its mail processing network and implement its area mail processing consolidations. And finally, concerns we raised in our 2006 report about the Service's progress in implementing delivery performance information.

Mr. Chairman, there is broad agreement on the Service's need to realign its processing networks. In addition to many of today's witnesses, the President's Commission and the Service's own transformation plan have called for action to assure that this network meets current and future processing needs, reduces costs, improves efficiency and eliminates redundancy.

The Postal Accountability and Enhancement Act reinforced the urgency of this realignment effort. We found that several trends have created excess capacity in the network and productivity variations across plants. First, the changing marketplace and shifts in how customers use the mail, in particular, declining first class mail volume and increasing standard mail volume.

Second, the changing role of mailers, as driven by work-sharing discounts, which involve mailers preparing, sorting or transporting mail to qualify for reduced postage rates. These activities allow mail to bypass mail processing and transportation operations.

Third, evolutionary changes have resulted in a network of plants that are markedly different from one another, making it difficult to standardize operations. And finally, shifts in national demographics. Service facilities may not be optimally located due to changing demographics and transportation modes.

Turning now to our concerns about the Service's realignment efforts, our 2005 report concluded that the Service did not have answers to important questions about how it intended to realign its mail processing networks. This conclusion still holds true today. We find that the Service's strategy for realigning its processing network first lacked clarity, criteria and processes for eliminating excess capacity in its network. Second, it largely excluded stakeholder input from its decisionmaking processes. Third, it was not sufficiently transparent and accountable; and fourth, lacked performance measures.

Mr. Chairman, I want to emphasize that we support the Service's efforts to realign its processing networks, but we do have some concerns. The Service has started to implement several network realignment initiatives. Overall, progress has been somewhat slow. These initiatives include area mail processing or AMP consolidations, development of a network of regional distribution centers, and creation of surface transportation centers.

The realignment efforts are at different stages of implementation. For example, in February 2006, the Service said that it was planning to develop a network of between 28 and 100 regional distribution centers that would serve as the foundation for its processing network. However, the Service is apparently reconsidering this approach and Tuesday issued a request for information regarding hiring private suppliers to handle some or all business mail. At this point, it is not clear how these various initiatives are integrated or whether they are meeting the realignment goals.

AMP consolidations focus on moving processing activities from one plant to another to achieve efficiencies. Our report raises sev-

eral issues related to these consolidations. Concerns raised by us and others include the Service's unclear criteria for selecting facilities and deciding on AMP consolidations, use of inconsistent data calculations, limited measures of the effect of changes on delivery performance and lack of clarity regarding how stakeholder and public input is solicited and used.

It is important to note that the Service is revising its guidelines for AMP consolidations to address these issues. After reviewing a draft of these changes, we made two recommendations. First, that the Service ensure that the facilities plan required by the Postal Accountability and Enhancement Act explains the integration of realignment initiatives and establishes measurable targets, and second, that the Service continue to improve the quality of public notices and engagement and increase transparency in decision-making.

We reported last year on the Service's limited progress in measuring and reporting on its delivery performance. The report detailed the limited scope of the Service's delivery measures, which covered less than one-fifth of mail volume. We also covered the need to update delivery standards to reflect current operations, particularly for standard mail and periodicals.

We reported on impediments to progress and recommended the Service provide clear management commitment and more effective collaboration with mailers to implement delivery measurement and reporting for all major types of mail.

In conclusion, the Postal reform law offers the Service opportunities to respond to our recommendations from all these reports and requires the Service to submit a plan to Congress describing the strategy, criteria and processes for realigning its network.

Also, the Service must develop modern service standards and annually report to the PRC on the speed and reliability of delivery of most types of mail.

Mr. Chairman, this concludes my statement. I am happy to answer any questions the subcommittee may have.

[The prepared statement of Ms. Siggerud follows:]

United States Government Accountability Office

GAO

Testimony

Before the Subcommittee on Federal Workforce, Postal Service, and the District of Columbia, Committee on Oversight and Government Reform, House of Representatives

For Release on Delivery
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U.S. POSTAL SERVICE

**Progress Made in
Implementing Mail
Processing Realignment
Efforts, but Better
Integration and
Performance Measurement
Still Needed**

Statement of Katherine Siggerud, Director
Physical Infrastructure Issues



July 26, 2007

U.S. POSTAL SERVICE

Progress Made in Implementing Mail Processing Realignment Efforts, but Better Integration and Performance Measurement Still Needed



Highlights of GAO-07-1083T, a testimony before the Subcommittee on Federal Workforce, Postal Service, and the District of Columbia, Committee on Oversight and Government Reform, House of Representatives

Why GAO Did This Study

GAO reported in 2005 on major changes in the mailing industry that have reinforced the need for the U.S. Postal Service (USPS) to reduce costs and increase efficiency. To address these changes and become more efficient, USPS is implementing initiatives aimed at realigning its mail processing network. In a follow-up review, GAO recently reported that USPS has made progress in implementing these initiatives, yet challenges such as maintaining delivery standards and addressing stakeholder and community resistance remain. In July 2006, GAO also reported on USPS's progress in improving delivery performance information. This testimony describes (1) the changes that have affected USPS's processing network, (2) GAO's concerns related to USPS's strategy for realigning its mail processing network and implementing its area mail processing consolidations, and (3) GAO's concerns related to USPS's progress in improving delivery performance information. This testimony is based on prior GAO reports.

What GAO Recommends

GAO made recommendations to USPS to enhance the planning, accountability, and public communications related to its realignment efforts and to improve its delivery performance measures. USPS's response to the statutory requirements enacted in December 2006 is an opportunity to address GAO's recommendations.

www.gao.gov/cgi-bin/getrpt?GAO-07-1083T.

To view the full product, including the scope and methodology, click on the link above. For more information, contact Katherine Siggerud at (202) 512-2834 or siggerudk@gao.gov.

What GAO Found

Several major changes have affected USPS's mail processing operations, including marketplace changes, declining First-Class Mail volume, increased competition, increased mail processing by mailers, automated operations, and population shifts. These changes have led to excess capacity in USPS's mail processing network and variations in productivity among plants.

GAO's 2005 report concluded that USPS's strategy for realigning its mail processing network lacked clarity, sufficient transparency and accountability, excluded stakeholder input, and lacked performance measures for results. Since then, USPS has developed several initiatives that are at varying stages of development to address these issues and major changes with an overall goal of reducing costs while maintaining service. In 2007, GAO reported that while USPS has made progress in implementing its realignment initiatives, (1) USPS still did not have answers to important questions about how it intended to realign its network, (2) it remains unclear how various USPS initiatives are individually and collectively contributing to achieving its goals, and (3) the area mail processing (AMP) consolidation initiative, to which USPS attributes most of its progress in reducing excess machine capacity, still presents significant issues. These issues include unclear criteria used in selecting potential AMP consolidations, inconsistent data calculations, limited measures of the effects of changes on delivery performance, and a lack of appropriate stakeholder and public input. USPS is developing new policies to address some of these issues. Nevertheless, questions about USPS's selection criteria continue as USPS has decided not to implement 34 of the 57 potential AMP consolidations it considered in 2005 and 2006 as shown in the table below. With limited data on the effects of changes, USPS cannot consider actual delivery performance in making consolidation decisions or in evaluating results.

Status of AMP Consolidation Studies in 2005 and 2006

Status of AMP consolidation	2005	2006	Total
Approved for implementation	10	2	12
Implemented	9	1	10
Implementation pending	1	1	2
Decision not to implement	1	33	34
Decision still pending	NA	11	11
Total AMPs considered	11	46	57

Source: GAO presentation of USPS data.

GAO reported in 2006 that USPS does not measure and report its delivery performance for most types of mail and that its progress to improve delivery performance information has been slow and inadequate despite numerous USPS and mailer efforts. Postal reform legislation enacted in December 2006 requires USPS to submit a plan to Congress describing its strategy, criteria, and processes for realigning its network and provide performance measures for most types of mail. USPS is preparing its response to these requirements.

Mr. Chairman and Members of the Subcommittee:

I am pleased to be here today to participate in this oversight hearing for the U.S. Postal Service (USPS). In April 2005, we issued a report¹ that detailed the major changes that have affected USPS's mail processing and transportation operations and evaluated USPS's strategy for realigning its network to address these changes. We recently issued a follow-up report in June 2007,² which focused on the initiatives USPS has implemented to realign its network. We also issued a report³ in July 2006 that discussed our concerns with USPS's limited delivery performance information, which is needed to evaluate how USPS's network realignment decisions affect the quality of delivery service. As requested, my remarks today are based on these previous GAO reports and will focus on (1) major changes affecting USPS's mail processing operations that have prompted the need for network realignment, (2) the concerns we raised in our 2005 and 2007 reports related to USPS's strategy for realigning its mail processing network and implementing its area mail processing consolidations, and (3) concerns we raised in our 2006 report on USPS's progress in improving delivery performance information.

Summary

As we reported in 2005, several major changes have affected USPS's mail processing operations. These changes include the following:

- **A changing marketplace and shifts in how customers use the mail**—USPS is experiencing a decline in First-Class Mail volume—which declined by almost 6 percent from fiscal years 2001 through 2006—and has attributed this decline to how customers use the mail.
- **A change in the role of mailers**—This is primarily due to the advent and evolution of USPS's worksharing discounts, which began in 1976. Postal worksharing activities generally involve mailers preparing, barcoding,

¹GAO, *U.S. Postal Service: The Service's Strategy for Realigning Its Mail Processing Infrastructure Lacks Clarity, Criteria, and Accountability*, GAO-05-261 (Washington, D.C.: Apr. 8, 2005).

²GAO, *U.S. Postal Service: Mail Processing Realignment Efforts Under Way Need Better Integration and Explanation*, GAO-07-717 (Washington, D.C.: June 21, 2007).

³GAO, *U.S. Postal Service: Delivery Performance Standards, Measurement, and Reporting Need Improvement*, GAO-06-733 (Washington, D.C.: July 27, 2006).

sorting, or transporting mail to qualify for reduced postage rates.⁴ These activities allow mail to bypass USPS mail processing and transportation operations.

- **The evolution of USPS's automated equipment and processing and transportation networks**—USPS's use of manual and automated equipment and the related processing and transportation network have also evolved over time, resulting in an infrastructure network composed of plants that are markedly different from one another, which makes it difficult to standardize operations.
- **Shifts in national demographics**—USPS facilities may not be optimally located due to shifts in demographics and changes in transportation. USPS has stated that a key challenge is to locate processing plants and employees within efficient reach of most of the population while at the same time providing universal service to the rest of the nation at a reasonable cost.

These changes have created excess capacity in USPS's processing network (i.e., plants, machines, and transportation capacity) and have contributed to variations in productivity across USPS processing plants that impede efficiency gains. To address these changes and their impact, USPS, GAO, the USPS Inspector General, the President's Commission on the U.S. Postal Service, and the Postal Regulatory Commission (PRC)⁵ have all stated that USPS's processing network needs to be realigned.

In our 2005 report, we concluded that USPS did not have answers to important questions about how it intended to realign its mail processing networks. This conclusion still holds true today. In that report, we evaluated USPS's strategy for realigning its processing network—Evolutionary Network Development (END), an evolutionary strategy developed by USPS to realign its processing operations—and found that this strategy

⁴Key worksharing activities include (1) barcoding and preparing mail so USPS can sort it on automated equipment; (2) presorting mail, such as by ZIP code or specific delivery location; and (3) entering mail closer to destination, commonly referred to its destination entry or dropshipping.

⁵The Postal Regulatory Commission was previously named the Postal Rate Commission. Section 604 of the Postal Accountability and Enhancement Act (Pub. L. No. 109-435), enacted on December 20, 2006, redesignated the Postal Rate Commission as the Postal Regulatory Commission.

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- lacked clarity (since USPS announced its intent to realign, it has developed several different realignment strategies);
 - lacked criteria and processes for eliminating excess capacity in its network;
 - excluded stakeholder input from its decision-making processes;
 - was not sufficiently transparent and accountable; and
 - lacked performance measures for results.

We recommended that USPS establish a set of criteria for evaluating realignment decisions, develop a mechanism for informing stakeholders as decisions are made, and develop a process for implementing these decisions that includes evaluating and measuring the results as well as the actual costs and savings resulting from the decisions. We followed up on the actions USPS has taken related to these recommendations in our 2007 report and found that although USPS has taken some steps to improve its planning and evaluation processes, it still has not clarified the criteria it uses for selecting locations for potential area mail processing (AMP) consolidations and making decisions on whether or not to proceed with implementation.

As we stated in our June 2007 report, currently, USPS is implementing several key initiatives that play central roles in network realignment—AMP consolidations, regional distribution center (RDCs) development, the Flats Sequencing System,⁶ and surface and air network development—which are at different stages of implementation. Although we support USPS's efforts to facilitate the realignment of its processing network, we have some concerns about how USPS is implementing these initiatives. First, USPS still does not have answers to important questions about how it intends to realign its network. For example, in February 2006, USPS said that it was planning to develop a network of between 28 and 100 RDCs that would serve as the foundation for its processing network. In June 2007, we reported that USPS is reconsidering this network and it is not clear what the future foundation of the processing network will be. Second, it is not clear how these initiatives are individually and collectively integrated or to what extent they are meeting USPS's realignment goals, which include

⁶Flat mail includes larger envelopes, catalogs, circulars, newspapers, and magazines.

-
- developing mail processing and transportation networks suited to current and future operational needs,
 - reducing inefficiency and redundancy,
 - making operations flexible, and
 - reducing postal costs.

USPS is making changes to its processing network with the aim of meeting these goals while maintaining current levels of service, but USPS has yet to develop measurable targets for achieving these goals. With no measurable targets, it is not apparent how much of an impact USPS's network realignment initiatives are making toward achieving these goals. Third, during our review of these initiatives, we also found several issues with AMP consolidations—the initiative that most clearly addresses USPS's goal of reducing excess machine capacity. These issues include USPS's unclear criteria for selecting facilities and deciding on AMP consolidations, the use of inconsistent data calculations, limited measures of the effect of changes on delivery performance, and a lack of appropriate stakeholder and public input when considering potential AMP consolidations.

USPS is revising its procedural and communication guidelines for AMP consolidations to address some of these issues, but we continue to have some concerns, primarily with respect to integrating and measuring performance related to USPS's network realignment initiatives, communication procedures, and the transparency of its decision-making. To address these concerns, in our June 2007 report we recommended that the Postmaster General

- strengthen the planning and accountability for USPS's realignment efforts by ensuring that the Facilities Plan required by the Postal Accountability and Enhancement Act explains the integration of realignment initiatives and establishes measurable targets to track USPS's progress in meeting realignment goals and
- improve communication with stakeholders by modifying USPS's procedures to improve the quality of public notices and engagement, particularly those related to proposed AMP consolidations, and increase transparency in decision-making.

We reported in 2006 on our concerns related to USPS's limited progress in improving its delivery performance information, which, as we reinforced in our 2007 report, is needed to evaluate the effects of its network realignment decisions. A key concern of some stakeholders who may be affected by USPS's realignment decisions is whether delivery service will be negatively affected. Our 2006 report detailed the limited scope of USPS's delivery performance measures, which cover less than one-fifth of the mail volume. We also reported on the impediments to progress and recommended that USPS take actions to provide clear management commitment and more effective collaboration with mailers to resolve the impediments to implementing delivery performance measurement and reporting for all major types of mail. Since our report was issued, Congress passed postal reform legislation that requires USPS to submit a plan to Congress describing its strategy, criteria, and processes for realigning its network and provide the PRC annual performance reporting for the speed and reliability of delivery of most types of mail. We believe that USPS's response to these statutory requirements is an opportunity to address the recommendations from our three reports.

Several Major Changes Have Affected USPS's Mail Processing Operations Prompting the Need for Network Realignment

Several major changes have affected USPS's mail processing and distribution operations including marketplace changes, such as declines in First-Class Mail and increased competition, increased automation and mail processing by mailers, and shifts in population demographics. Historically, USPS's business model was dependent on revenues from increasing mail volumes to help cover the costs of its expanding infrastructure. This model has proven more difficult to sustain because First-Class Mail volumes—which generate high revenue per piece—are declining. USPS has attributed the declining First-Class Mail volume to the impact of electronic diversion as businesses, nonprofit organizations, governments, and households increasingly automate their financial transactions and divert correspondence to the Internet. At the same time as declines in First-Class Mail are taking place, Standard Mail (primarily advertising mail) volumes are increasing. The trends for First-Class Mail and Standard Mail, which currently combine for about 95 percent of mail volumes and 80 percent of revenues, experienced a historical shift in fiscal year 2005. For the first time, the volume of Standard Mail exceeded that of First-Class Mail. This shift has financial implications because First-Class Mail generates the most revenue and is used to finance most of USPS's institutional (overhead) costs, while Standard Mail generates less revenue per piece. It takes about two pieces of Standard Mail to make the same contribution to institutional costs as one piece of First-Class Mail.

The role of mailers has also changed in large part due to the advent of USPS's worksharing discounts in 1976 and the evolution of additional worksharing discounts in subsequent years. Postal worksharing activities generally involve mailers preparing, barcoding, sorting, or transporting mail to qualify for reduced postage rates. These activities allow mailers to bypass some USPS mail processing and transportation operations. Thus, for example, an activity called dropshipping allows the mailer a discount for bypassing the plant near where the sender of the mail is located and transporting the mail closer to its destination point. Worksharing contributes to excess capacity in USPS's operations because mail volumes bypass operations that occur early in USPS's processing network; in some cases, as with dropshipping, mail volumes bypass entire plants. Also, some plants have exclusively processed certain types of mail, which has driven up the cost per piece of those types of mail. In general, by law, each postal product must cover the costs attributable to its provision plus a reasonable contribution to cover institutional costs. Consequently, when a network is dedicated to only one type of mail, that type of mail must bear the costs of the dedicated network.

USPS's use of manual and automated equipment and the related processing and distribution network have also evolved over time, resulting in an infrastructure network composed of plants that are markedly different from one another. As a result, some plants cannot accommodate some types of processing equipment because the floor space requirements differ for manual and automated processing and the plants were not originally designed to house the advanced technology. In 2005, USPS's mail processing and distribution infrastructure included plants that ranged in age from 2 to 72 years old and ranged in size from just over 400 square feet to over 1.5 million square feet; have different layouts; serve different processing functions; and do not share the same amount and type of processing equipment.

Additionally, USPS facilities may not be optimally located due to shifts in demographics and changes in transportation. Most USPS processing plants are located in eastern states—in areas that historically have had the largest population. During the 1990s, U.S. households continued moving West and South, with Nevada and Arizona ranking as the two fastest growing states in the nation. In 2005, we reported that the majority of USPS processing plants are located in states where household growth has not been as rapid as in others. USPS stated that the challenge it faces is to locate processing plants and employees within efficient reach of most of the population, while at the same time providing universal service at a reasonable cost. Furthermore, as a result of ongoing changes in

transportation, most mail is now moved by highway and air, and some processing plants could be better located so that major highways and airports would be more easily accessible. In particular, changes in transportation occurred after the September 11, 2001, terrorist attacks, when new federal aviation security restrictions prohibited the transportation of mail weighing more than 16 ounces on commercial passenger flights. As a result, the majority of the mail previously transported by commercial passenger air is now shipped by surface transportation or flown by FedEx.

These major changes have led to variations in productivity and excess capacity in USPS's processing network, prompting the need for network realignment. Average productivity—total pieces processed per hour—varies among USPS's mail processing and distribution plants, which indicates that some plants are not processing mail as efficiently as others. USPS officials have attributed this variation to several factors, including size of plant as measured by workload, number of employees, plant layout, and use of nonstandardized processes. In our 2005 report, we found that none of these factors, in isolation, can explain the variations; rather, it seems that plants with low productivity exhibit a number of contributing factors.

These major changes have also created excess capacity in USPS's processing network. According to USPS officials, declining mail volume, worksharing, and the evolution of mail-processing operations from manual to automated equipment have led to excess capacity. Excess capacity created by these trends can be categorized into different types, including the following:

- excess machine hours, which occur when machines sit idle;
- excess physical infrastructure, which occurs when more square footage is available for processing mail than is necessary (this may include entire plants);
- excess transportation capacity, which occurs when trucks are run at less than full capacity; and
- excess work hours, which occur when more work hours are used than are necessary for processing the mail.

Concerns Related to USPS's Strategy for Realigning Its Mail Processing Network and Implementing its Area Mail Processing Consolidations

As we reported in 2005, and it continues to be the case today, important questions remain about how USPS intends to realign its mail processing network to meet its future needs because USPS does not have a comprehensive, transparent strategy for realigning its processing network. Since our 2005 report, USPS has been working on several key initiatives that play central roles in network realignment: AMP consolidations, RDC development, the Flats Sequencing System, and surface and air network development. In 2007 we reported that USPS has made progress in implementing these initiatives, but we have some concerns related to the integration and results of these initiatives, particularly the AMP consolidations.

USPS's Strategy for Realigning Its Mail Processing Network is Still Unclear

Our 2005 report concluded that USPS's strategy for realigning has not been clear because USPS has outlined several seemingly different strategies, none of which include criteria and processes for eliminating excess capacity, which may prolong inefficiencies. Also, we reported that USPS's strategy lacks sufficient transparency and accountability, excludes stakeholder input, and lacks performance measures for results. In 2007, we reported that while USPS has made some improvements, it still is not clear how USPS intends to realign its mail processing network. The RDC initiative, which USPS referred to as the foundation of its processing network, is one key area of USPS's network realignment that is unclear.

In February 2006, USPS testified to the PRC that it would be undertaking an initiative to develop a network of RDCs to serve as the foundation of its processing network.⁷ However, various developments have caused USPS to reexamine whether it will proceed with the RDC initiative. RDCs would serve as consolidation centers for mail of the same shape (i.e., letters, flats, or parcels), which would allow mailers to bring various classes of mail to one facility and facilitate the transportation of multiple mail classes on a single transportation network. When USPS first introduced the concept of RDCs to serve as the foundation of its processing network, it projected it would need between 28 and 100 RDCs nationally.

In February 2007, officials told us that they would be reevaluating processing and transportation network plans in light of the December 2006

⁷In February 2006 USPS, sought an advisory opinion from PRC on anticipated changes in the application of current service standards that may result from a systemwide review and realignment of its mail processing and transportation networks, and PRC issued its advisory opinion in December 2006.

Postal Accountability and Enhancement Act, the PRC opinion, and the planned deployment of new equipment to sort flats. In March 2007, USPS's Senior Vice President, Operations, told us that USPS is still determining the structure of its processing network foundation. He said that similar to the current network, the future network would be designed around USPS's processing and distribution centers, but how USPS will make determinations about these facilities appears largely uncertain.

**Mail Processing
Realignment Efforts USPS
Has Under Way Need
Better Integration and
Measurable Targets**

USPS has developed initiatives to facilitate the realignment of its processing network, but without measurable targets for cost savings or benefits, it is not clear how these initiatives are meeting its END goals. The goals of USPS's END include (1) developing mail processing and transportation networks suited to current and future operational needs, (2) reducing inefficiency and redundancy, (3) making operations flexible, and, (4) reducing costs.

The four major initiatives discussed in our June 2007 report are shown in Table 1.

Table 1: Status and Purpose of Central Realignment Initiatives

Initiative	Status	Purpose
Area mail processing consolidations	In progress	Increase efficiency and use of existing machine capacity by consolidating mail processing operations. (of the 57 potential consolidations USPS studied in 2005 and 2006, 10 have been implemented and most of the remaining will not be implemented)
Regional distribution center development	Reconsidering	Provide essential infrastructure for a more efficient processing network
Flats Sequencing System*	Under development	Increase processing efficiency by automating flat mail sorting to carrier delivery sequence, (deployment of machines for this purpose is expected between October 2008 and October 2010)
Surface and air network development	Near completion	Improve transportation network flexibility and efficiency. (20 of 23 surface transportation centers have been opened and the remaining are expected to open in 2007)

Source: GAO presentation of USPS data.

*Flat mail includes larger envelopes, catalogs, circulars, newspapers, and magazines.

USPS has established goals for its END infrastructure realignment and is making changes to its processing network with the aim of meeting these goals while still maintaining current levels of service. While GAO, PRC, and the President's Commission have supported these goals, USPS has yet

to develop measurable targets for achieving them⁸. It also is unclear how USPS's realignment initiatives are integrated with each other, that is, how the individual and collective costs and benefits of these initiatives impact the overall goal of network realignment. Without measurable targets, the impact of USPS's network realignment initiatives on achieving these goals is not apparent. For example, USPS's Senior Vice President, Operations, told us that there are no actual targets for cost savings in network realignment but an indicator of success would be the implementation of more AMP consolidations.

Concerns with the AMP Consolidation Process

We also raised several issues in our June 2007 report about the AMP consolidations, in which certain mail-processing operations from multiple plant locations are consolidated into fewer plant locations. AMP consolidations are the initiative that most clearly addresses USPS's reduction of excess machine capacity due to increased worksharing and declining First-Class Mail volumes, yet the limited transparency in the AMP consolidation process makes it unclear the extent to which this initiative is meeting END goals. Many of the concerns about this lack of transparency in the planning and evaluation processes are primarily related to the criteria USPS used in selecting operations at certain facilities as opportunities for AMP consolidations, the lack of consistent data calculations used in the decision making and evaluation processes, the lack of the AMP consolidation's evaluation of impact on service performance, and the lack of appropriate stakeholder and public input. USPS is taking steps to address these areas by revising its AMP consolidation guidelines, but concerns still exist.

AMP consolidations are intended to reduce costs and increase efficiency by reducing excess machine capacity. One way to reduce excess capacity is to consolidate mail-processing operations from one or more plants into another plant(s). This increases the amount of mail processed on machines and decreases the work hours used in mail processing by reducing the number of staffed machines. By decreasing the number of machines used to process mail, AMP consolidations can reduce postal costs.

⁸In July 2003, the President's Commission provided recommendations on ensuring efficient USPS operations, while minimizing financial exposure to the American taxpayer. These recommendations supported USPS's realignment of its processing network.

In 2005 and 2006, USPS considered 57 studies of opportunities for AMP consolidations, but has decided not to implement 34 of them. See the appendix for more detail on the status of these AMP consolidations. As summarized in table 2, in 2005, USPS considered 11 consolidations, of which it implemented 9, postponed 1, and did not implement 1.

Table 2: Status of AMP Consolidations Studies in 2005 and 2006

Status of AMP consolidation	2005	2006	Total
Approved for implementation*	10	2	12
Implemented	9	1	10
Implementation pending	1	1	2
Decision not to implement	1	33 ^b	34
Decision still pending	NA	11	11
Total AMPs considered	11	46	57

Source: GAO presentation of USPS data.

*USPS originally approved 11 AMP consolidations in 2005 and subsequently decided not to implement 1.

^bDecisions not to implement proposed AMP consolidations include 5 consolidations USPS placed on indefinite hold.

In 2006 USPS initiated 46 AMP consolidation studies. As of May 2007, it had implemented 1 consolidation, approved but not yet implemented 1 consolidation, decided not to implement 33 studies (5 placed on indefinite hold), was continuing to consider 10 consolidations, and was still completing the study of 1 consolidation. USPS officials explained that area officials decided to place 5 AMP consolidation studies on indefinite hold because of existing delivery service issues in the areas served by these facilities, which the officials wished to resolve before considering implementation. USPS officials said that the remaining 28 of the 33 decisions not to implement the proposed consolidations were made because, for example, studies had found that implementation would result in negligible savings or degrade existing service. USPS anticipates it will make final decisions for the remaining feasibility studies still under consideration this summer.

Unclear Criteria Used in AMP Consolidation Decisions

The criteria USPS uses for both selecting locations that may serve as potential opportunities for AMP consolidations, and deciding whether to implement a consolidation are unclear. Therefore, USPS may not be targeting the best opportunities for consolidation. In 2005, USPS used modeling software that identified 139 sets of locations where operations could potentially be consolidated. Of these, 46 sets of locations were

deemed feasible for initiating AMP consolidation studies in 2006; and of these sets, 2 have been approved so far for AMP consolidations, and 33 have been either rejected or put on hold. In its December 2006 advisory opinion, PRC questioned not the model itself, but rather the effectiveness of the model's use in identifying opportunities for AMP consolidations. PRC's concerns are related to the fact that the END model does not rely completely on location-specific data in identifying opportunities for consolidation. Instead, the model uses some location-specific data in combination with national productivity averages, which may not adequately target the best opportunities for consolidations. The USPS Inspector General also recently reported on USPS's selection process for AMP consolidations.

In addition to having unclear criteria in selecting locations with potential for consolidating mail processing operations, USPS does not have specific criteria—such as definitive thresholds or principles—for deciding whether or not to implement an AMP consolidation after the study has been completed. USPS's Senior Vice President, Operations, told us that USPS is considering prioritizing consolidations that are expected to achieve \$1 million or more in cost savings annually.

Inconsistent Data Calculations

We also reported that USPS did not use consistent data calculations in determining the impact and cost savings of these consolidations. Inconsistency in data calculations in the feasibility studies may limit USPS's ability to identify all of the foreseeable impacts of the consolidations and to accurately determine the expected cost savings of the AMP consolidations. The current AMP guidelines do not prescribe standardized sources for the data used in completing the worksheets, nor is there a standardized methodology for calculating some data in the worksheets.

AMP consolidation guidelines require semiannual and annual post implementation reviews (PIR) of AMP consolidations, which ensure management's accountability for implementing an AMP plan. USPS's post implementation review process essentially replicates the AMP consolidation study process and compares the estimated annual savings submitted in the approved AMP consolidation study to the actual savings after 6 months, which is then projected to annualized savings. PIRs are completed by local managers, approved by area officials, and subject to final review by headquarters officials.

We found that in some cases, reviewing officials in USPS headquarters made significant corrections and changes to the draft PIRs that were

submitted for their review, resulting in revised projected annualized savings that were closer to the original estimates prepared for the AMP consolidation studies. As shown in table 3, the sum of estimated annual savings in the nine AMP consolidations approved in 2005, as provided in the AMP study documents, was about \$28 million.⁹ According to the initial draft PIRs for these nine consolidations prepared by USPS officials at the local level 6 months after implementation, the annualized savings would be about \$19 million. During the review of these PIRs by USPS headquarters, this sum was revised to about \$28 million.

Table 3: Semiannual Post Implementation Projected Annualized Savings Versus Estimated Annualized Savings in AMP Studies Approved in 2005

Number of PIRs	Estimated annualized savings in AMP studies	Initial post implementation projected annualized savings (prepared by local officials)	Revised post implementation projected annualized savings (based on headquarters review)
9	\$28,142,829	\$19,017,453	\$28,112,909

Source: GAO presentation of USPS data.

Note: The headquarters review of the PIRs has been completed for only three of the nine PIRs, and additional revisions to the projected annualized savings may be made, but USPS officials provided us with the most recent data available from their ongoing reviews.

While the differences in the savings from the AMP studies' estimated annualized savings and the revised PIR projected annualized savings are generally small, in the interim, drafts of the PIRs showed different projections before USPS headquarters officials revised them based on their review. USPS's Senior Vice President, Operations, told us that the headquarters review has shown that when PIRs have not been finalized, they do not always account for all of the actual savings achieved by the AMP consolidation. Another USPS official attributed the difference in the amounts reported in some PIRs and the revised projected annualized savings to unexpected events (e.g., changes in cost elements, such as work hour rates) and differences in the methodologies used by the individuals calculating the data impact of the results.

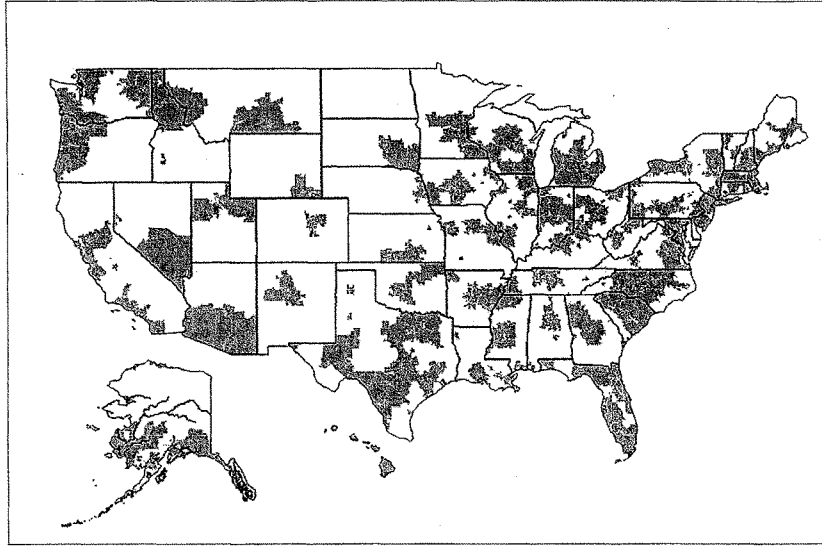
⁹USPS headquarters officials also revised the AMP studies' estimated annual savings for two consolidations after the consolidations were approved to eliminate duplicate savings, which reduced the AMP studies' total estimated annual savings by \$2.8 million. We did not include this revised AMP estimate in the table because we wanted all the data in the table to be from consistent sources.

Limited Delivery Performance Measures

The AMP consolidation process does not evaluate potential impacts to delivery performance; therefore, USPS cannot determine the actual impact of AMP consolidations on delivery service. As we reported in 2006, USPS does not measure and report its delivery performance for most types of mail, and less than one-fifth of total mail volume is measured.¹⁰ While USPS is taking steps toward developing increased delivery performance measurements, limited mechanisms are currently in place to determine how AMP consolidations may potentially impact delivery performance or to evaluate the actual impact after implementation. USPS has systems in place to measure delivery performance for some of its First-Class Mail and segments of other types of mail. However, the External First-Class Measurement System (EXFC) is limited to single-piece First-Class Mail deposited in collection boxes in selected areas of the country (see fig. 1). Thus, some areas included in potential AMP consolidations may not be covered by the EXFC system; therefore, USPS would not have delivery performance information for these areas.

¹⁰GAO-06-733.

Figure 1: Geographic Coverage of Delivery Performance Measurement for First-Class Mail Deposited in Collection Boxes as Measured by EXFC



Source: U.S. Postal Service.

Note: Areas covered by EXFC are shaded. Boundaries within states are for 3-digit ZIP Code areas.

While the AMP consolidation study does not take delivery performance into account, it does review impacts on service standards, which are USPS's official standards for how long it should take to process different classes of mail between the location where USPS receives the mail (originating ZIP codes) and its final destination (destinating ZIP codes). The AMP consolidation study considers whether standards for different classes of mail will be upgraded (a decrease in the time it takes mail to travel between certain ZIP codes) or downgraded (an increase in the time it takes mail to travel between certain ZIP codes) with implementation of

Lack of Stakeholder and Public Input

the consolidation. Considering these service standards provides some insight into the potential impact of the AMP consolidation on USPS's ability to meet its internal standards; however, without service performance data or the ability to measure the AMP consolidation's impacts on delivery performance, it is unclear how USPS can accurately determine the cost and service impact of its AMP consolidations.

USPS's AMP communication practices do not ensure appropriate stakeholder engagement in realignment decisions. More specifically, AMP consolidation communication processes (1) do not provide clear and useful notification to stakeholders, (2) do not provide for meaningful public input and lack transparency into the AMP decision-making process, and (3) provide limited information to the public after USPS makes AMP consolidation decisions. A town hall meeting is the only formal requirement for public input during the AMP consolidation process. Stakeholders and others have criticized the timing of the meeting, saying it occurs too late in the process, after USPS has already made major decisions.

AMP consolidations have been taking place since the late 1960s, and USPS established AMP consolidation guidelines in 1979. However, until 2006, USPS has had no statutory requirement to contact the public (other than USPS employees) concerning the consolidation of its operations, unless the consolidation would result in a retail facility closure. In 1995, prior to the statutory requirement, USPS established communication guidance requiring the notification of stakeholders when an AMP consolidation is implemented, and in 2005 this guidance was updated to require notification when AMP consolidation studies are initiated. AMP consolidation notification letters sent to stakeholders were not meaningful and provided little detail. The notification letters we reviewed were largely form letters, did not simply and clearly state the type of change or changes being studied, and provided no range of possible outcomes for the public to understand. Letters contained jargon with terms that may not be familiar to the public. For example, they stated that USPS was studying the facility's "total mail processing," "originating/destinating mail processing," or "originating mail processing." Also, the letters did not provide the name of the facility to which operations would be moved so that mailers affected by the change could plan their operations accordingly. Furthermore, USPS did not explain to stakeholders that "consolidating both originating and destinating mail" meant USPS was considering closing the facility, whereas consolidating "either destinating or originating mail" meant potential changes only to internal mail processing operations.

AMP guidance requires USPS to “fully consider” both service and “other impacts on the community.” Since 2006, USPS has included a requirement in its AMP guidance for a town hall meeting to provide a forum to obtain public input, but there are flaws with that requirement. As noted in our report, USPS held five town hall meetings that were open to the public and has held another since our report was issued. USPS provided little information about the study prior to the meetings—a series of bullets was posted on a USPS Web site several days prior to the meetings, and USPS neither publicized an agenda for the meetings nor employed a neutral party to facilitate them. According to the guidance, additional information in the form of briefing slides and a video screening, is not made available to attendees until a meeting occurs. Then, a USPS official will prepare a summary document after the meeting that is to be forwarded to USPS headquarters. Only after the meeting, do the stakeholders and the public have an opportunity to draft and submit comments to USPS.¹¹

Additionally, we found that these meetings occur too late in the decision making process. Public meetings were held after the AMP consolidation studies were forwarded to USPS headquarters, and after USPS had gathered and analyzed most of the data, including the data on customer service impacts. USPS officials could not specifically explain how stakeholder and public input was used in reaching AMP consolidation decisions. Furthermore, USPS does not seek input from stakeholders or the public—including input regarding impact on delivery service—when evaluating completed AMP consolidations. However, USPS officials told us that as a matter of practice, USPS provides its employee organizations with copies of approved AMP studies and completed AMP evaluations. It is unclear how the information collected at, or subsequent to, the meetings, factors into consolidation decisions.

Revised AMP Guidelines and
New Legislation Are
Addressing Some of These
Issues, but Concerns Remain

Although USPS is revising its AMP consolidation procedural and communication guidelines to address some of these issues, we continue to have some concerns. Drafts of these revised procedural guidelines indicate that the new process will include several changes aimed at standardizing the AMP consolidation process and the data calculations used in studying potential consolidations. The use of consistent data sources should alleviate some of the delays that currently affect the AMP consolidation process. USPS officials stated that the revised guidelines are currently

¹¹For the five meetings that were held, USPS afforded stakeholders and the public 5 days to provide comments. USPS has since increased the comment period to 15 days.

scheduled to be released this summer.¹² However, we have concerns about the draft guidance because it does not

- address USPS's limited use of facility-specific data in identifying facilities to consider for consolidation,
- identify the criteria USPS uses when deciding to approve an AMP consolidation, or
- address USPS's limited ability to measure delivery performance.

While USPS is updating its communication guidance—the *AMP Consolidation Communication Plan and Toolkit*—its proposed improvements would neither substantively improve information provided to stakeholders and the public, nor improve the public input process. Proposed improvements would help clarify which stakeholders USPS notifies but would not improve the content of the notifications. Furthermore, the draft AMP consolidation guidelines would not provide for transparency into the AMP consolidation decision-making process to the extent that Congress has encouraged and others have recommended or advised by, for example, holding the public meeting earlier or explaining how USPS uses public input.

To address these concerns, in our recent report we made the following two recommendations to the Postmaster General:

1. Strengthen the planning and accountability for USPS's realignment efforts by ensuring that the Facilities Plan required by the Postal Accountability and Enhancement Act¹³ includes
 - a discussion of how the various initiatives that will be used in rationalizing the postal facilities network will be integrated with each other and
 - the establishment of measurable targets USPS plans on meeting for the anticipated cost savings and benefits associated with network

¹²USPS plans on providing a draft of the guidelines to employee unions for their review. Unions are allowed 60 to 90 days for review and comment.

¹³The Postal Accountability and Enhancement Act requires USPS to develop a Facilities Plan that includes a strategy for how USPS intends to rationalize the postal facilities network and remove excess processing capacity and space from the network and the process for engaging policymakers and the public in related decisions.

rationalization, and the timeline for implementation.

2. Improve the way in which USPS communicates its realignment plans and proposals with stakeholders, particularly with regard to proposed AMP consolidations, by taking action to

- improve public notice by clarifying notification letters,
- improve public engagement by holding the public meeting earlier in the study, and
- increase transparency by updating AMP guidelines to explain how public input is considered in the decision-making process.

In its response to our recent report, USPS generally agreed with our findings and stated that it will be taking measures to address our recommendations. USPS commented that its compliance with the Postal Accountability and Enhancement Act will satisfy our recommendations for the Postmaster General to ensure that the required Facilities Plan addresses the integration and performance measurement issues we identified. We agree that the required Facilities Plan provides an opportunity for USPS to more fully discuss the integration of its realignment initiatives and establish measurable targets for meeting the cost savings and benefits of network rationalization.

Additionally, USPS agreed to improve public notice by providing clear and simple language detailing the type of change being considered and forecasting changes to customer services, as well as by soliciting public input at the initiation of the feasibility study. The public notice will outline a formal comment period and inform stakeholders that comments will be addressed later at a public meeting. USPS agreed to improve public engagement by holding the public meeting earlier in the AMP process. We agree that this change in timing will improve USPS's public engagement process as well as the usefulness of public input in AMP consolidation decisions. The agenda and briefing slides will be posted on www.usps.com in advance of the public meeting. USPS also agreed to increase the transparency of the AMP process by adding information to the AMP guidelines on how USPS uses public input in the decision-making process. Public input information will be appended to the AMP proposal provided to the Area Vice President for a decision. The input will be weighed against the proposal's overall impact on cost savings and service. If the AMP proposal is approved by the Area Vice President, it will be forwarded along with the public input information to the Senior Vice President,

Operations. The final report will be posted on www.usps.com and will summarize the impact of the approved proposals on savings, service, and other stakeholder concerns.

Progress in Improving Delivery Performance Measures Has Been Slow and Inadequate

Our July 2006 report found that USPS does not measure and report its delivery performance for most types of mail, and less than one-fifth of total mail volume is measured (see table 4). We also reported that USPS has made inadequate progress in modernizing its delivery standards and in implementing delivery performance measurement for all major types of mail. Our report discussed multiple impediments that have contributed to USPS's slow progress toward implementing representative measures of delivery performance for all major types of mail. The most important impediment was the lack of management commitment and effective collaboration with the mailing industry to follow up on recommendations for improvement and to resolve issues between USPS and mailers. Additional impediments included technological limitations, limited mailer participation in providing information needed to facilitate performance measurement, data quality deficiencies, and costs. USPS's limited progress has left major gaps in each of these areas, despite numerous recommendations for improvement that have been made in these areas over the years, including those by USPS-mailer task forces and working groups, as well as some USPS initiatives to develop delivery performance measurement. We recommended that USPS take actions to facilitate greater progress in developing complete delivery performance information.

Table 4: USPS Measurement and Reporting of Timely Delivery Performance

Type of mail	Mail volume (percent)	Mail revenue (percent)	Representative measurement	Reporting on USPS Web site
Standard Mail	47.7	28.4	None*	None
First-Class Mail: bulk	24.6	23.7	None*	None
First-Class Mail: single-piece	21.7	30.4	Partial	Partial
Periodicals	4.3	3.2	None*	None
Package Services	0.6	3.3	Partial	Partial
Priority Mail	0.4	7.0	Partial	Partial
International Mail	0.4	2.6	Partial	None
Express Mail	0.03	1.3	Full	Partial

Source: GAO analysis of U.S. Postal Service information.

Note: Timely delivery performance is measured based on comparing the time for USPS to deliver mail against USPS's delivery standards. Reporting includes material on USPS's Web site. For purposes of this table, First-Class Mail does not include Priority Mail. Volume and revenue data are for fiscal year 2005 and do not add up to 100 percent because they do not include some small and unrelated types of mail.

*No representative measure of delivery performance exists for this mail. Some mailers pay an additional fee to obtain data on the progress of their mail through USPS's mail processing system. However, these data are not representative, cover less than 2 percent of total mail volume, and do not include data on the date of delivery.

While USPS is taking steps toward developing increased delivery performance measurements, limited mechanisms are currently in place to determine how AMP consolidations may impact delivery performance or to evaluate the actual impact after implementation. A key concern of some stakeholders who may be affected by USPS's realignment decisions is whether their delivery service will be negatively affected. The Postal Accountability and Enhancement Act enacted in December 2006 provides additional opportunities for USPS to address the concerns we raised. The act requires USPS to establish modern delivery service standards by December 20, 2007, and implement annual reporting of the speed and reliability for most types of mail (market-dominant products¹⁴) according to specific requirements to be established by the PRC. In addition, the act requires USPS to annually report on the quality of service it provides for each of these products. USPS is in the process of consulting with mailers, PRC, and the public on how this modernized system of service standards and measures should be developed. We believe this process of dialogue and obtaining a broad cross-section of input is a good start and we look forward to new USPS and PRC regulations in this area, which are expected later this year.

Mr. Chairman, this concludes my prepared statement. I would be pleased to respond to any questions that you or the Members of the Subcommittee may have.

¹⁴The Postal Accountability and Enhancement Act defines market-dominant products to include: First-Class Mail letters and sealed parcels, First-Class Mail cards, periodicals, Standard Mail, single-piece parcel post, media mail, bound printed matter, library mail, special services, and single-piece international mail.

**Contact and
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Appendix I: Status of USPS 2005 and 2006 AMP Consolidations

Status of AMP Consolidations Approved In 2005 (as of May 2007)

Facilities involved in consolidation (facility losing operations/facility gaining operations)	Implemented	Implementation postponed	Subsequent decision not to implement
Bridgeport, CT/ Stamford, CT	√		
Greensburg, PA/ Pittsburgh, PA	√		
Kinston, NC/ Fayetteville, NC			√
Marina, CA/ Los Angeles, CA	√		
Marysville, CA / Sacramento, CA	√		
Mojave, CA/ Bakersfield, CA	√		
Monmouth, NJ / Trenton, NJ & Kilmer, NJ	√		
Northwest Boston, MA/ Boston, MA	√		
Olympia, WA/Tacoma, WA		√	
Pasadena, CA/ Santa Clarita, CA & Industry, CA	√		
Waterbury, CT/ Southern Connecticut, CT	√		
Total	9	1	1

Source: GAO presentation of USPS data.

Status of 46 AMP Consolidations Initiated in 2006 (as of May 2007)

AMP package under review at district or area management	AMP package under review by headquarters	Proposed AMP review on hold	Decision not to implement proposed AMP	AMP approved
1	10	5	28	2
Daytona Beach, FL/ Mid-FL, FL	Aberdeen, SD/ Dakotas Central, SD	Alamogordo, NM/ El Paso, TX	Beaumont, TX/ Houston, TX	Newark, NJ/ Kearny, NJ
	Bronx, NY/ Morgan, NY	Batesville, AR/ Little Rock, AR	Binghamton, NY/ Syracuse, NY	Saint Petersburg, FL/ Tampa, FL
	Canton, OH/ Akron, OH	Carbondale, IL/ Saint Louis, MO	Bloomington, IN/ Indianapolis, IN	
	Dallas, TX/ North Texas, TX	Centralia, IL/ Saint Louis, MO	Bryan, TX/ Houston, TX	
	Flint, MI/ NE Metro, MI	Las Cruces, NM/ El Paso, TX	Burlington, VT/ White River Jnt, VT	
	Jackson, TN/ Memphis, TN		Cape Cod, MA/ Brockton, MA	
	Kansas City, KS/ Kansas City, MO		Carroll, IA/ Des Moines, IA	
	Oshkosh, WI/ Green Bay, WI		Cumberland, MD/ Frederick, MD	
	Sioux City, IA/ Sioux Falls, SD		Fox Valley, IL/ South Suburban, IL	

AMP package under review at district or area management	AMP package under review by headquarters	Proposed AMP review on hold	Decision not to implement proposed AMP	AMP approved
	Waco, TX/ Fort Worth/Austin, TX		Gaylord, MI/ Traverse City, MI	
			Glenwood Springs, CO/ Grand Junction, CO	
			Helena, MT/ Great Falls, MT	
			Hutchinson, KS/ Wichita, KS	
			LA Crosse, WI/ Rochester, MN	
			McAllen PO TX/ Corpus Christi, TX	
			McCook & N. Platte, NE/ Casper, WY	
			Plattsburg, NY/ Albany, NY	
			Portsmouth, NH/ Manchester, NH	
			Rockford, IL/ Palatine, IL	
			Sheridan, WY/ Casper, WY	
			Springfield, MA/ Hartford, CT	
			Staten Island, NY/ Brooklyn, NY	
			Twin Falls, ID/ Boise, ID	
			Ulrica, NY/ Syracuse or Albany, NY	
			Watertown, NY/ Syracuse, NY	
			Wheatland, WY/ Cheyenne, WY	
			Yakima, WA/ Pasco, WA	
			Zanesville, OH/ Columbus, OH	

Source: GAO presentation of USPS data.

Note: This table includes the facilities involved in proposed consolidations, both the facility losing operations and the facility gaining operations.

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Mr. DAVIS OF ILLINOIS. Thank you, Ms. Siggerud. Now we will turn to Mr. Milbourn.

STATEMENT OF GORDON C. MILBOURN III

Mr. MILBOURN. Mr. Chairman and members of the subcommittee, I appreciate the opportunity to discuss the Postal Service's network and its recent realignment efforts. I will also address our work in this important area and some of the challenges remaining.

We describe the Postal Service's network in detail in our testimony submitted for the record, and an overview diagram is attached. As you know, the Postal Service has one of the world's largest distribution networks, built on the premise that first class mail volume and revenue will continually rise and cover costs.

However, in recent years, single piece first class mail volume has decreased substantially. In addition, the increasing automation of formerly manual processes and work-sharing discounts that keep mail out of parts of the processing stream, have left the Postal Service network over-sized.

In 2001, GAO placed the Postal Service on its high risk list, and Congress asked for a plan to address GAO's concerns. In response, the Postal Service's 2002 transformation plan included a redesign of its logistics networks, called Network Integration and Alignment [NIA]. Our NIA reviews identified the potential for stakeholder concerns about the fairness and accuracy of the process and the need for policies and procedures for independent verification and validation of the project models.

In September 2004, the Postal Service announced the Evolutionary Network Development [END] initiative, as the next step in optimizing its networks. The Postmaster General indicated the change to END was made because of the unpredictability of mail volume and processing. A key feature of implementing END is the Area Mail Processing [AMP] study, which is used to consolidate mail processing functions, eliminate excess capacity and increase efficiency.

Our END concerns have centered on the need for more effective resolution of stakeholder issues for both a top-down and bottom-up approach in using AMPs and for better project management. In reviewing some of the AMPs, we found their conclusions adequately supported, but we reported concerns, such as data problems and incomplete service impact documentation.

The Postal Service is currently implementing our recommendations to improve the AMP process. Most recently, in October 2006, Postal Service management announced a reexamination of the assumptions behind the END initiative. This was followed closely by passage of the Postal Accountability and Enhancement Act, which requires a realignment plan by June 2008. Planning for large-scale projects can vary from long-range detailed plans with elaborately sequenced steps to short-range incremental approaches. Each has its merits and the Postal Service has chosen the incremental approach, which provides network flexibility as circumstances change, reduces risks inherent in attempting to make all network changes at once, allows testing via pilot projects in a more forgiving environment, generates incremental internal capital to cover the cost

and tends to make the overall picture clearer as local problems are resolved.

In recent years, this incremental approach has allowed the Postal Service to make progress in optimizing its network. For example, it has eliminated over 180 million work hours and converted over 30 facilities to a new infrastructure.

This approach has also highlighted many significant challenges still being faced in realigning the network. For example, not all postal stakeholders share the same goals, as found in such fundamental issues as providing universal 6-day service, which may not make economic sense in all locations, and eliminating mail acceptance points, which would streamline the network and save costs, but often produces mailer opposition.

The mix of volume and types of mail is constantly changing. Relationships with mailers are continuously evolving in regards to discounts and mail preparation and submission requirements. And the velocity of the build-down must avoid protracted, anemic staffing of an over-sized network which can lead to operational and service failures.

The act does not specify a planning model and the Postal Service believes it is well served by using an order of battle approach that incorporates flexibility and expects external change to occur throughout the process. The Postal Service network must reach an optimal size that still provides enterprise resilience in the event of major disruptions, natural disasters or acts of terrorism.

Further, robust measurement is needed to monitor cost and service impacts as the plan unfolds. Finally, the plan must be effectively communicated to all stakeholders to prevent surprises and a negative impact on customer service. The support of Congress and the Postal Regulatory Commission is critical during this time of great change in order for the Postal Service to continue providing universal service at affordable prices.

We will continue to support postal efforts, and we are cognizant of our responsibility to keep Congress fully and currently informed. I will be pleased to answer any questions.

[The prepared statement of Mr. Milbourn follows:]

**Hearing before the Subcommittee on Federal Workforce,
Postal Service, and the District of Columbia
Committee on Oversight and Government Reform
United States House of Representatives**



**Long Statement for the Record
On the
Infrastructure and Realignment of the U.S. Postal Service**

**Gordon C. Milbourn III
Assistant Inspector General for Audit
Office of the Inspector General
United States Postal Service**

Mr. Chairman and members of the subcommittee, I appreciate the opportunity to submit my testimony concerning the Infrastructure and Realignment of the U.S. Postal Service. I would like to comment on the Postal Service's current network and its previous network realignment efforts. In addition, I would like to share with you the work of the Office of Inspector General (OIG) in this important area, Postal Service progress in network realignment, and some of the challenges we foresee for the Postal Service in planning and executing realignment activities.

Postal Service Network

The Postal Service operates one of the world's largest distribution networks, processing, transporting, and delivering more than 213 billion pieces of mail annually, and interfacing daily with the \$900 billion a year domestic mail industry. This network of more than 700,000 employees, tens of thousands of facilities, many different types of processing equipment, and multiple modes of transportation provides universal 6-day service to more than 300 million customers.

The bricks and mortar of the network consist of almost 37,000 retail and delivery facilities, more than 600 processing facilities, and approximately 1,000 other facilities such as those for administrative, vehicle maintenance, and miscellaneous support purposes.

There are six main types of retail and delivery facilities:

- Over 27,300 Post Offices serve as the basic organizational unit of the Postal Service with the primary responsibility for collection, delivery, and retail operations in specific geographical areas.
- Nearly 5,000 Classified Branches and Stations are post office facilities operated by postal employees in owned or leased facilities for collection, delivery, and retail operations.
- Over 570 Carrier Annexes are separate buildings letter carriers use instead of a post office. These buildings exist because adequate space is not available at the post office, or they meet a logistical location need.
- More than 3,000 Contract Postal Units are subordinate postal units within the service area of a main post office. They are usually located in a store or place of business and operated by a contractor who accepts mail from the public, sells postage and supplies, and provides selected special services such as postal money orders or registered mail.
- Nearly 940 Community Post Offices are contract postal units that provide service in small communities where independent post offices have been discontinued.

Once mail is collected at post offices, it is transported to plants which sort and distribute it for delivery¹. The mail is categorized into letter-size mail, flat-size mail, and parcels.² For many years the mail category determined the process for sorting, transporting, and distributing it for delivery; in recent years the Postal Service has learned it can commingle different categories in the transportation network. The more than 600 facilities which process the mail are of nine basic types:

- Nearly 270 Processing and Distribution Centers (P&DC) process and dispatch mail from the local area, along with other mail received from postal processing facilities outside of the local area, for delivery to customers or shipment to different facilities for further processing. Key components of the P&DC system are Business Mail Entry Units (BMEU) and Detached Mail Units (DMU), where the largest volume of mail enters Postal Service processing. Business mail is accepted at 1,900 BMEUs located at postal facilities (many are at P&DCs), and at 850 DMUs located in mailer or intermediary facilities. After receiving the business mail, the BMEUs and DMUs send it to the P&DCs for processing. The BMEUs and the DMUs account for approximately 55 percent of the Postal Service's revenue and more than 73 percent of its volume.

¹ Page 26 of this document contains processing diagrams and narrative for First-Class Mail and Standard Mail processing.

² Flat-size mail exceeds the dimensions for letter-size mail. Parcel mail does not meet the mail processing category of letter-size mail or flat-size mail.

Mail processing uses both automated equipment and manual operations. In the case of letter mail processing, the Advanced Facer Canceler System (AFCS) and the Delivery Bar Code Sorter (DBCS) are the main automation equipment used. The AFCS locates the stamp, uses it to face each mail piece in the same direction, cancels the mail, sprays an identification barcode on the envelope, and sorts the mail to a set of bins for further processing. Once the initial processing is complete the DBCS sorts the letter mail in letter carrier delivery walk sequence. This eliminates the need for sorting by the letter carriers and allows the letter carriers to load the mail directly into their vehicles for delivery.

The Automated Flats Sorting Machine 100 (AFSM 100) and the Upgraded Flats Sorting Machine 1000 (UFSM 1000) are the main equipment used to process flat-size mail. The AFSM 100 is a fully automated sorting machine designed to streamline flats mail processing operations and reduce manual processing. The AFSM 100 receives mail via automatic feeders and processes mail using optical character recognition technology. The UFSM 1000 is capable of sorting flat mail pieces that are beyond the size capabilities of the AFSM 100. The UFSM 1000 can sort both non-barcoded mail and barcoded mail. A keyboard operator identifies and enters the proper keycode for each non-barcoded mail piece and the UFSM 1000 sorts the mail piece to the correct bin based on the

operator's input. On the other hand, the equipment automatically sorts barcoded mail.

A significant component of future flats mail automation is the Flats Sequencing System (FSS). This equipment is designed to put flat mail, such as catalogs and magazines, in delivery route sequence for the letter carriers. This will eliminate the need for letter carriers to manually sort this type of mail. The Postal Service anticipates this technology will provide annual operating savings of approximately \$612 million. The installation of FSS is scheduled to begin in 2008 and be completed by 2011.

The Automated Package Processing System (APPS) and the Small Parcel and Bundle Sorter (SPBS) process parcels. The APPS sorts parcels and bundles of mail using automatic package induction and address recognition. In addition, the APPS collects detailed information about each package — such as its type, size and weight — using an optical character reader. The SPBS sorts small parcels, irregular parcel post, bundles of mail, and priority mail into as many as 100 separations. The SPBS is an operator-paced machine. The mail is introduced through input hoppers, which feed conveyors that present parcels to the operators who key the mail pieces' ZIP code destinations. The mail pieces are then mechanically transported to bins for delivery.

- Almost 70 Annexes are an extension of a mail distribution facility, such as a P&DC, that processes incoming and outgoing mail for a designated service area.
- The 195 Customer Service Facilities (CSF) are smaller-sized processing plants similar to P&DCs. These facilities allow access to additional geographic areas and usually report to a post office; however, larger CSFs report directly to an area office. A CSF contains equipment similar to a P&DC, but on a much smaller scale.
- More than 20 Bulk Mail Centers (BMC) are highly mechanized mail processing plants that receive and ship large volumes of Standard Mail, periodicals, and parcels. These facilities can contain APPS and SPBS. In addition, BMC operations rely on conveyers and the Singulation Scan Induction Unit (SSIU). The SSIU is a high-speed processing unit that scans bar-coded parcels and sorts them to their outgoing destination ZIP code for delivery.
- The 11 Logistic and Distribution Centers (L&DC) were initially developed to assure rapid processing and delivery of Priority Mail. Excess capacity allowed non-Priority Mail to be added to these locations. L&DCs may also process First-Class Mail® and Standard Mail, and may operate as a central dispatch point. L&DCs generally have at least SPBS, UFSM 1000, or APPS for mail processing.

- The 20 Surface Transfer Centers (STC), also known as “hubs,” are critical nodes in the Postal Service's surface transportation network. STCs provide concentration points that receive and consolidate surface mail from locations across the country and transfer it to vehicles leaving the hub for final plant destinations. This technique allows the Postal Service to combine loads, maximize vehicle capacity, dispatch full vehicles, and save money by eliminating unneeded trips. Postal Service officials plan to open two additional STCs during fiscal year (FY) 2007, as they continue to increase their emphasis on ground transportation and decrease their emphasis on air transportation. The mail processing equipment in an STC will vary from location to location, and may include equipment to sort trays and packages such as APPS and SPBS machines.
- Almost 60 Airport Mail Centers (AMC) are hubs for the Postal Service's air transportation network and located at major airports. An AMC receives mail from the Postal Service's ground transportation network, distributes or “tenders” that mail to commercial air carriers for airport-to-airport transportation, monitors mail in air carriers' possession, supervises air carriers' mail handling operations during aircraft loading and unloading, recovers mail from air carriers, and redistributes mail for onward transportation and delivery. The mail processing equipment in an AMC will vary from location to location and, depending on Area requirements, some larger facilities may have equipment similar to that found in a P&DC.

- The 12 Remote Encoding Centers (REC) use video images to assign barcodes to mail that mail processing machines at regular processing locations cannot read. The barcode is imprinted on the mail, allowing the mail piece to be returned to automated mail processing.
- The five International Service Centers (ISC) distribute, dispatch, and receive international mail. The mail processing equipment in an ISC will vary from location to location and can include UFSM 1000, APPS, and DBCS machines.

Transportation is a key component of the overall network. The retail/delivery and processing portions of the network are connected by 16,727 highway routes. Approximately 216,000 vehicles operate in the network and 2.3 billion pounds of mail are carried on contract air routes annually.

Recent Changes Impacting the Network

The existing network developed over time to support the Postal Service's historic business model that relied on rising First-Class Mail volume to cover the cost of operating the expanding delivery network and its significant infrastructure investment. However, in the last 6 years single piece First-Class Mail volume has decreased by over 6.1 billion pieces. During the same time, the delivery network expanded by 8.0 million new delivery points and continues to expand by approximately 2 million new mail delivery points each year.

The decline in single piece First-Class Mail volume is due in large part to electronic diversion as businesses, nonprofit organizations, governments, and households increasingly rely on e-mail and other electronic means to conduct financial transactions and send correspondence. This dynamic was not, of course, anticipated in 1970 when the business model was established.

Besides the impact of declining single piece First-Class Mail volume, the Postal Service's network is affected by such things as worksharing, mail processing automation, and providing the "last mile of delivery." These impact revenue and costs in ways that are dynamic and not always easily predicted, and have left the Postal Service network oversized.

Worksharing — This occurs when a mailer (or mailer agents) does part of the work the Postal Service itself would normally perform in exchange for a discount. The idea is that if the mailer can do the activity at a lower cost than the Postal Service, then they should do it themselves and save the Postal Service the costs it would otherwise bear (and for which the mailer would pay). For example, mailers generally have accurate address databases. They can receive a discount for such things as placing address automation barcodes on each piece of mail. This saves the Postal Service processing costs and it is more

economical for the mailer to ensure correct addresses on the mail than for the Postal Service to incur the costs of handling undeliverable mail. Worksharing is believed to have cut costs, spurred volume growth, and lowered postage rates. It has been estimated that worksharing saves the Postal Service approximately \$11 billion to \$15 billion a year, and many believe it has benefited mailers, the mailing industry, consumers, and the economy at large.

Another example of worksharing is the drop shipment of mail. This involves movement of a mailer's products via private (non-postal) transportation from the point of production to a postal facility located closer to the destination of those products. A simplified scenario could be a mailer preparing a mailing in Wheeling, West Virginia for delivery in Fairfax, Virginia. Instead of mailing it in Wheeling, it would be taken by private transportation to the local Northern Virginia P&DC where it would be processed for delivery to residents in Fairfax. This saves the Postal Service processing costs in Wheeling and the transportation costs between the two processing plants. In turn, the mailer gets a discount based on a predetermined formula. This type of arrangement is clearly a "win/win" for everyone. However, the Postal Service must consider the long-term impact of these arrangements and directly plan with the mailers to ensure that adequate processing capability exists at the receiving processing plant and that by-passed processing plants are not overstaffed and underused as this mail volume moves past them. Over 70 percent of all Standard Mail is drop shipped to the Postal Service.

Mail Processing Automation — Between FY 2000 and FY 2006, the Postal Service approved \$5.8 billion in engineering investments that are expected to produce \$19 billion in savings over their useful life. The Postal Service generally does not invest in automation equipment unless it can be expected to generate at least a 20 percent return on investment. With overall volume levels growing slowly, automation has facilitated cost cutting in workhours for processing and delivery operations.

The Postal Service continues to make significant strides in automating mail processing. This can be seen in the improving flats and parcel technology, which is maturing and benefiting from technology adapted from letter automation systems. As noted earlier, the Postal Service anticipates FSS technology will provide annual operating savings of approximately \$612 million starting in 2012.

The value of automation technology can be seen with letter mail sorting technology, which has increased the Postal Service's productivity by sorting mail to delivery walk sequence, thereby eliminating much of the manual handling of this mail. Sorting mail by automation is more than 10 times cheaper than manual processing – it costs \$5 to sort 1,000 letters through automation versus more than \$55 to sort the same amount manually.

Automation savings contribute to the Post Service's Total Factor Productivity (TFP), which is a measure of postal efficiency and cost-effectiveness. TFP is a ratio of output (workload) to input (resources). Workload includes the number of delivery points and mail volume. Resources include labor, materials, transportation, and capital. Postal Service productivity for the last 7 years has grown at an average annual rate of 1.5 percent. In 2006 the TFP improved by 0.4 percent. This is a notable achievement considering that from 1972 to 1999 the average annual growth rate was 0.3 percent. The recent annual TFP trend is encouraging as it seems to be a departure from the historic gain/loss cycle.³ However, sustaining the current trend may prove to be a challenge. The recent TFP increases are a direct result of the Postal Service's efforts to use fewer workhours, but it may not be possible to continue cutting these costs indefinitely. Labor comprises 79 percent of the total operating expenses of the Postal Service, and it has limited flexibility to manage labor costs. To sustain TFP growth, the Postal Service must have the freedom to adjust its network and staffing levels to operate at maximum efficiency. At the same time, it is important to ensure that TFP growth does not come at the expense of the employees' workplace environment or service to the customer.

Last Mile of Delivery — The Postal Service has the nation's most comprehensive delivery network, providing universal service to more than 300 million customers

³ Historically, during times of increasing mail volume growth, the Postal Service experienced TFP gains. However, when mail volume growth slowed, so did productivity.

6 days a week. The portion of the network from the post office to the customer's door is commonly called the "last mile."

The Postal Service has been able to leverage this last mile into "co-opetition" with United Parcel Service, Federal Express, and DHL for delivery to residential addresses. In addition, the Postal Service connects the digital economy of online shopping with the traditional one by being able to touch all neighborhoods, urban and rural, with delivery services.

Postal Service Network Realignment Efforts

In April 2001 the U.S. Government Accountability Office (GAO) placed the Postal Service on its High-Risk List⁴ and called for the Postal Service to develop a comprehensive plan to address its financial, operational, and human capital challenges. The following month the GAO called for the Postal Service to develop a comprehensive transformation plan and noted the deteriorating financial outlook. In June 2001, Congress endorsed the GAO's recommendations and requested a comprehensive transformation plan from the Postal Service.

⁴ The GAO began the "high-risk" program in 1990. It focuses on the major programs and operations in need of urgent attention and transformation to ensure that the Federal government functions in the most economical, efficient, and effective manner possible.

In April 2002 the Postal Service issued its *United States Postal Service Transformation Plan* (Transformation Plan). The Transformation Plan recognized the Postal Service faced changing customer needs, declining mail volumes, rising costs outside its direct control,⁵ fixed infrastructure costs to support universal service, global competition in both domestic and foreign markets, and increasing security costs. One of the cost-saving strategies the Postal Service said it would implement was the redesign of the logistics network to optimize the number and location of processing centers, processing strategies for mail, and transportation modes and routes to meet customer service requirements at minimal total system costs.

The Transformation Plan characterized the redesign of postal logistics networks as the Network Integration and Alignment (NIA) initiative. The NIA charter was to create a flexible logistics network that reduced the Postal Service's and customers' costs, increased overall operational effectiveness, and improved consistency of service. This initiative included simplifying and downsizing the network, redefining the roles and functions of processing plants, and consolidating mail and transportation operations. NIA anticipated examining over 500 processing and transportation-related facilities and evaluating all modes of transportation for cost and service performance, with the potential for doing an overall redesign of the national surface transportation network.

⁵ The Postal Service identified these costs as retirement and health benefit liabilities.

NIA relied on optimization and simulation models. Management used the optimization models to identify alternatives and generate a network solution given certain inputs and constraints associated with a proposed scenario. The simulation models were used to test the feasibility of the solutions given service performance and resource utilization statistics for specific network alternatives coming from the optimization model. Because of the complexity of the Postal Service's network, management used the simulation models at the national, regional, and facility levels.

In September 2004, the Postal Service announced that the Evolutionary Network Development (END) initiative would be the next step in rationalizing and optimizing its networks. According to the Postmaster General, the change from NIA was made because of the unpredictability of mail volume and processing. END was intended to use an incremental approach, allowing the Postal Service to continually rationalize its networks to keep them efficient and affordable.

In early 2006, the Postal Service publicly announced its END plans to redesign its mail processing and transportation networks. The Postal Service anticipated it would take several years to effect the realignment and implement operational changes using an incremental approach, and factored in the *Area Mail Processing (AMP) Guidelines* to help with implementation. The AMP is used to consolidate mail processing functions and to eliminate excess capacity, increase

efficiency, and better use resources. The END network simplification plan centered on regional distribution centers, local processing centers, destination processing centers, airport transfer centers, surface transportation centers, and remote encoding centers. The plan was to reduce network facilities from more than 600 facilities to just over 400 facilities.

However, in October 2006, management announced they were stepping back and reexamining the assumptions behind the END initiative, as well as remodeling the previous NIA network used to create the regional distribution center concept centered on APPS machines. An important aspect of the new modeling was to consider the impact of both APPS and FSS.

Shortly after that, the Postal Accountability and Enhancement Act (the Act) became law. It requires the Postal Service to develop a plan by June 20, 2008 that describes how it will increase the efficiency and effectiveness of its systems, processes, and facilities for delivering the mail. In considering the Act, Congress⁶ found the Postal Service has more facilities than it needs and streamlining and consolidating sorting facilities would eliminate excess costs.

⁶ Pub. L. 109-435, Section 302(c)(1)(B)

Office of Inspector General Work

Since 2002 the OIG has been reviewing both the forward-looking NIA and END initiatives, and the current postal processing operations and transportation networks. In the case of NIA, our specific reviews in 2003 and 2004 led us to conclude that:

- The Postal Service could be subject to fairness and accuracy criticisms as was the Department of Defense base realignment and closing process in the 1980s and 1990s.
- The Postal Service needed policies and procedures for independent verification and validation for the NIA models.
- A separate contractor or an independent Postal Service team was needed to conduct verification and validation for the NIA models.

During this time we worked with the GAO to ensure adequate oversight without duplicating efforts. Concurrent with our findings, the GAO reported the Postal Service needed to develop strategies to realign its infrastructure and expressed concerns about the level of public transparency for financial and operating information, including the transformation. The GAO recommended the Postmaster General develop a comprehensive plan to optimize the Postal Service's infrastructure and workforce, in collaboration with its key stakeholders, and make it publicly available.

In 2005, our work shifted focus to the END initiative. We reported that:

- Stakeholder opposition challenged the initiative.
- The Postal Service needed a top-down and bottom-up approach for using AMPs to address incremental closings and stakeholder resistance.
- The Postal Service needed a project office and integration plans apart from local management.

Even though management announced it was stepping back and reexamining the END initiative, we have continued our AMP work. In 2006, we developed a model to rank proposed AMPs according to risk. To date, we have ranked approximately 40 proposed AMPs, completed audits of four of the AMP processes, and are currently working on one other which we will report on in late summer.

In the four completed audits we generally found management complied with their overall guidelines and maintained adequate documentation to support their conclusions. However, management did not always comply with the specific AMP processes and there were weaknesses in some management controls. We also identified inconsistent, inaccurate, incomplete, or unsupported AMP proposal data. In a systemic audit of 10 AMP proposals, we told the Postal

Service they could improve the documentation of service impacts. In particular, the Postal Service did not always fully document service standard upgrades and downgrades for certain classes of mail such as First-Class Mail and periodicals. This was due, in part, to inadequate handbook guidance and inconsistent use of guidelines. In addition, we assisted management by assessing proposed AMP worksheets as part of the Postal Service's ongoing AMP guideline revision. We have made a number of recommendations to improve the AMP process, which the Postal Service is currently implementing.

Our audit work since 2002 to assist the Postal Service in optimizing its \$25 billion processing and transportation networks has identified potential cost avoidance and savings. Our plant efficiency reviews target operations that will optimize individual processing facilities. In conducting the individual plant efficiency reviews, we look at such things as staffing, productivity, overtime, idle time, mail volume trends, and equipment performance. Our work continues to focus on facilities that show overall performance below national averages.

Our transportation audit work since 2002 has looked at various network segments to find ways to reduce costs via eliminating redundancy in highway and rail transportation, better managing logistical support costs such as those for fuel and the vehicle fleet, and optimizing the air network. This work has identified potential cost savings in the transportation network and opportunities to improve

its ability to meet operational demands today, as well as its ability to realign and make needed infrastructure changes in the future.

Postal Service Progress

Postal Service accomplishments in recent years using an incremental approach to network optimization include:

- Reducing 180.5 million workhours (which equates to 86,779 staff years);
- Closing over 90 mail facilities;
- Converting over 30 facilities to a new network infrastructure; and
- Reducing highway contract routes by over 65 million miles.

Organizations can use very different approaches to plan for large-scale projects. These vary from a long-range, detailed plan with elaborately sequenced steps for the entire project, to a short-range, more incremental approach. Each has its merits, and the Postal Service, as previously noted, has elected to use the incremental approach. Given the size, complexity, and expense of this undertaking, it appears that taking this approach to network changes represents an acceptable method for reducing inefficiencies and standardizing best operational practices. This approach has been reasonable considering that other

major government modernization efforts⁷ that used traditional strategic planning approaches nevertheless experienced significant cost overruns and delays.

The incremental approach:

- Provides network flexibility to allow for easier changes as demographics, mail mix, and technology evolve;
- Reduces risks inherent in attempting to make all network changes at once;
- Allows testing via pilot projects in a more forgiving environment; and
- Generates incremental internal capital to cover the cost of network optimization.

The Postal Service's incremental experience and successes should help it construct a strategy in accordance with the Act because working with smaller pieces such as the AMPs has made the overall picture clearer to understand. It also has clarified many of the challenges the Postal Service faces with comprehensive network realignment.

⁷ Examples include the Internal Revenue Service, Federal Aviation Administration, and Department of Defense modernization projects.

Network Realignment Challenges

Although the network picture is clearer now than in 2002, the complete realignment will not be easy to accomplish. One reason is that not all postal stakeholders share the same goals. These stakeholders include the individual customer, mailers, postal unions, and the Congress. The 1970 business model anticipated the Postal Service would operate as a business and the Act reinforces the business model by delineating competitive and non-competitive products. However, management continues to receive mixed signals from its key stakeholders about its business vs. public service roles, complicating its optimization efforts. These mixed signals are found in such fundamental issues as:

- Universal 6-day service – It may not make economic sense in all locations, but the interests of the Congress and the tax payers may be contrary to that of the rate payers.
- Opposition at the local, state, and national levels to closing post offices – Many are not strategically located or may not be essential for mail service and represent a cost no other public or private entities are required to bear.
- Opposition to eliminating mail acceptance points – Many may no longer be needed to operate the network and their elimination would save costs, but mailers often oppose any reduction in the number of available entry points.

- The prohibition against what is referred to as "crossing crafts"⁸ – This may slow the Postal Service's efforts to increase efficiencies in mail processing and delivery.
- Management of letter carrier costs – To achieve a significant breakthrough in delivery costs, the Postal Service needs to explore an incentive-based letter carrier performance system, regardless of how it currently classifies delivery routes.
- Concerns about contracting out some functions – The Postal Service is considering this option for a significant portion of the BMC network operated by approximately 20,000 postal employees.

The Postal Service must reconcile these sometimes conflicting messages from influential stakeholders and mitigate their risks where possible to preclude paralyzing inaction.

Other significant challenges confronting the Postal Service in this effort include:

- The constantly changing mix of volume and type of mail in the midst of an ongoing communications revolution.

⁸ The labor agreements between the Postal Service and three of its four major unions — the American Postal Workers Union, the National Postal Mail Handlers Union, and the National Association of Letter Carriers — state that "normally, work in different crafts, occupational groups or levels will not be combined into one job." This is a prohibition against what is referred to as "crossing crafts," which cannot be done except in accordance with certain restrictive provisions.

- Evolving relationships with mailers in regard to discounts and mail preparation and submission requirements.
- The need for the velocity of the builddown to avoid protracted anemic staffing of an oversized network which can lead to operational and customer service failures.
- The extremely dynamic environment in which the Postal Service operates, especially compared to the more stable environments in which most other government entities function.
- Continuously advancing technological capabilities, which are not always easily predicted.
- The need to understand, evaluate and, where necessary, mitigate the effect of the builddown on standardization.

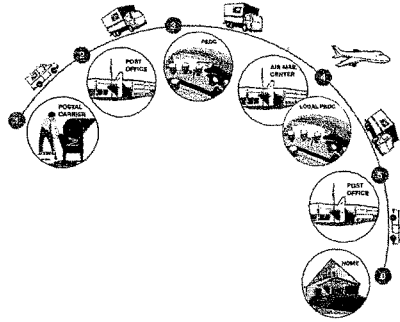
Conclusion

Although the Act does not specify a planning model to be used, the Postal Service believes it is well served by using an "order of battle" approach that incorporates flexibility and expects external change to occur throughout the process. The Postal Service needs to prepare and plan as best it is able to reach an optimal network size that still provides enterprise resilience in the event

of major disruptions, natural disasters or acts of terrorism. Further, robust measurement is needed to monitor cost and service impacts as the plan unfolds. Finally, the plan must be effectively communicated to all stakeholders to prevent surprises and a negative impact on customer service. For example, mailers must understand well in advance the mail acceptance impacts to their business. Likewise, postal employees must understand how their jobs will be impacted.

The support of Congress and the Postal Regulatory Commission is critical during this time of great change for the Postal Service to remain a viable business providing universal mail service at affordable prices to the American public. My office will continue to support postal efforts and we are cognizant of our continuing responsibility to keep Congress fully and currently informed.

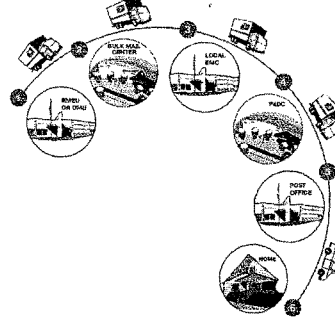
First-Class Mail Processing



An example of First-Class Mail processing is a greeting card mailed from Alexandria, Virginia, to Los Angeles, California. This card would be processed as follows:

- It is picked up from a mailbox by a carrier and brought to the local post office.
- It is next transported to the Northern Virginia Processing and Distribution Center (P&DC) where:
 - First, it joins other letters and packages for separation by mail handlers with the assistance of mechanization that separates the mail based on its size.
 - Next, an Advanced Facer Canceled System applies the postmark and cancels the postage stamp.
 - Then, a Delivery Bar Code Sorter (DBCS), operated by a mail processing clerk, applies a barcode reflecting the proper destination.
 - Last, the greeting card is subsequently sorted to the first three digits of the ZIP Code by the same DBCS that applied the barcode and then sent to its next destination. (Multiple sorts are required because of the high number of five-digit ZIP Codes.)
- Next, the card is transported to the Washington-Dulles Air Mail Center (AMC) in Virginia and flown to the Worldway Air Transfer Office (ATO) in California.
- After arriving at the Worldway ATO, mail is transferred to the Los Angeles P&DC, where mail processing clerks again use the same type of DBCS to perform a final sort of the mail by ZIP Code for the letter carrier.
- Finally, the greeting card is transported to the local post office to be picked up by a letter carrier and delivered to the addressee.

Standard Mail Processing



An example of Standard Mail processing is a package mailed from Arlington, Virginia, to Dallas, Texas, that takes the following steps:

- The package enters the mail stream via a Business Mail Entry Unit (BMEU) in Northern Virginia, a post office, or a detached mail unit (DMU) (an area in a mailer's facility where postal employees perform mail verification, acceptance, dispatch, and other postal functions).
- It is then transported to the Washington, DC, Bulk Mail Center (BMC) where it is sorted by clerks and mail handlers. Unlike First-Class Mail, this mail generally does not need to be separated or have stamps cancelled because postage stamps are not used. Mailers apply other types of postage such as metered postage or permit imprint.
- Next, using a Small Parcel and Bundle Sorter (SPBS) or the Automated Package Processing System (APPS), the package is sorted to its three-digit ZIP Code for Dallas.
- The package is then transported to the Dallas BMC for final sorting to its five-digit ZIP Code for the letter carrier, using a SPBS or the APPS.
- Finally, the package is transported to the Dallas P&DC for dispatch to a post office, where a letter carrier delivers it to the addressee.

Mr. DAVIS OF ILLINOIS. Thank you both very much.

I will begin questions. I will begin with you, Mr. Milbourn. You just indicated that the Postal Service's network should be resilient to such things as natural disasters or acts of terrorism. Could you enhance that for us?

Mr. MILBOURN. Absolutely. There are really two what I would consider main considerations when we think about enterprise resilience with the Postal Service's network. One involves what you just alluded to, localized or regional catastrophes of one kind or another, such as Hurricane Katrina or the anthrax attacks that occurred here in the Washington area a few years back.

But there are also regular, significant events that affect the whole country. And what I mean by that is what we call the annual Christmas surge that occurs in November and December. This is one area that requires some degree of resilience in the network. The other is being able to resume processing and delivery in the event of a catastrophe such as a Hurricane Katrina that puts some facilities or post offices temporarily out of operation.

The Postal Service has capacity in its network right now to handle these types of events. The challenge as we see it is that as they begin to streamline the network, can they continue to build in some resilience to handle the Christmas surge and to be prepared for catastrophes such as these. We think it is going to be very difficult to find the right balance between the costs that would be involved with that and the actual risk of a disruptive event.

Mr. DAVIS OF ILLINOIS. So are you suggesting in terms of planning that the Service might put additional emphasis or more emphasis on planning for these likelihoods?

Mr. MILBOURN. Absolutely. These need to be carefully considered. The likelihood of the risk, which in the case of the annual Christmas surge is 100 percent. The likelihood of a Katrina is far less than that, but the impact of a Katrina in a local area is very significant. So there are ways to address those risks. It doesn't mean you have to build a network that is constantly large and can handle them. But you need to think about ways of sharing the risk, tying in with other networks that may be of assistance if something like that occurs. It just needs to be carefully thought out and planned for.

Mr. DAVIS OF ILLINOIS. Thank you very much.

Ms. Siggerud, in the GAO report that you released today, GAO recommended that the Postal Service enhance the planning, accountability and public communications related to its realignment efforts. How did the Service respond to that recommendation?

Ms. SIGGERUD. We made observations in several different areas. Let me start with the AMP consolidations themselves. I said in my short statement that we had some concerns about the data analysis and criteria used in that process. Because the Postal Service is in the midst of revising those guidelines in ways that seemed largely responsive to concerns raised by us, the IG and the PRC as well, we didn't make specific recommendations there.

Where we did make recommendations was in the communications side of the House. In particular, we have concerns about the content of some of the material that goes out to explain what is being studied and what actions might be taken. We thought those

could be clarified and simplified in a number of ways. The Postal Service did agree with that.

We also were concerned about this event called the town hall meeting and its timing with regard to when it could best bring useful information to bear on the AMP consolidations. The Postal Service also agreed that there would be some benefit to moving that town hall meeting earlier in the process.

Finally, the Postal Service did not have, at the time we were doing our work, any indication in its guidelines how it would actually use this information obtained from the public through the town hall meeting or other sources. It has also agreed to clarify that.

Then finally with regard to talking about integration and planning, we view the report that is due next June as the Postal Service's opportunity to respond to and explain what it plans to do in a number of areas having to do with realignment of the network.

Mr. DAVIS OF ILLINOIS. In 2006, GAO reported that the Postal Service did not measure and report its delivery performance for most types of mail and that its progress to improve delivery performance information has been slow and inadequate. Has the Postal Service made progress in measuring and reporting delivery performance since that time?

Ms. SIGGERUD. Yes, we have seen some progress, mainly in planning and thinking about how it is that it will accomplish those activities that you just mentioned. Because the Postal Accountability and Enhancement Act called for development of modern service standards and for information about that to be reported to the Congress this December, the Postal Service has put together a series of work groups that are in fact making progress on those issues. We have been observing those activities, and it looks like there are a lot of ideas out on the table, and that this report that is coming out this December is promising in terms of its responsiveness to the issue on the standards.

With regards to measurement, there's two activities going on. The Postal Service will be required to report to the Postal Regulatory Commission on its delivery performance. It will take some time before the information that is needed will be available on a large scale basis to deliver on that. So there need to be some decisions made about whether there will be sort of interim measures used before the concept of intelligent mail provides more widespread and reliable information.

In addition, of course, the Postal Regulatory Commission is setting up its own regulations about what would constitute the best type of information in terms of delivery performance. There has been a lot of activity on that front as well, in terms of comments provided to the Regulatory Commission from mailers and other stakeholders.

Mr. DAVIS OF ILLINOIS. Thank you very much.

Mr. Marchant.

Mr. MARCHANT. Thank you, Mr. Chairman.

Ms. Siggerud, your report in 2005 and 2007 concluded that the Postal Service is not sufficiently transparent and accountable on how it intends to realign its processing network. Transparent and accountable to who?

Ms. SIGGERUD. Well, I would say of course to the Congress itself, which has an interest in this area. To the public and as well to the mailing industry which relies on the Postal Service for an important part of the economy.

What we are really saying here is that when there is a transformation effort of some kind, which is really what this is, that the concept of transparency, and we have also said this in other areas, of course, transparency is really what are we trying to accomplish, what are our views on how we are going to get there. And then accountability is really then how do we know when we get there, how are we going to measure our performance. There are a variety of ways to accomplish this type of effort. The Postal Service is making progress on those concepts with regard to some of these individual efforts that I talked about. The plan as a whole, though, is still somewhat in development and lacking in a few of those areas.

Mr. MARCHANT. Do you think that the fact that the major element that the labor negotiations and the contract with the letter carriers, do you think it is possible for the Postal Service to make those final changes and those final plans and make them available until they finalize those negotiations and know what their work force costs are going to be, etc?

Ms. SIGGERUD. Well, yes, we think it is. Clearly the waiver issue and the cost associated with labor is very important in planning. But I really, a lot of what we are talking about here of course is also the network itself and the fixed costs associated with that. We have seen a fair amount of progress in certain areas of this network planning. What we haven't seen is an integration of what the vision is and how we are going to get there. I understand that the Postal Service places a very substantial challenge in this area. But it has been clear from the transformation plan the Postal Service put on itself, the President's Commission and from the direction from the Reform Act in December that there is a very strong interest in making progress and having some of the transparency and accountability that we have been talking about.

Mr. MARCHANT. What would you consider to be your most important concern over at the Post Office, in their realignment?

Ms. SIGGERUD. In the realignment area, well, I think what we would like to see is some clear goals set for this realignment effort in terms of timeframes, in terms of costs to be achieved, for example. And if a plan could be put together, some vision, perhaps, even for segments of the realignment that we are talking about, so that the mailing industry, the public and the Congress have some sense of what to expect, that would be, in our view, very good progress.

Mr. MARCHANT. Mr. Milbourn, what do you see as the biggest network realignment challenge?

Mr. MILBOURN. I agree with Ms. Siggerud that the one she just cited is enormous. I would add to that by saying, I think the ability of the Postal Service to reduce its costs substantially while still delivering service equal to, if not better than, the service that it currently delivers, is an enormous challenge. And that incorporates streamlining of the network. But you alluded to the work force and union negotiations, it kind of goes beyond that. But I think the streamlining of the network is a huge piece of that, and how they are able to plan for and accomplish massive streamlining focused

on costs and still be able to focus on and deliver the service at the same time is a real challenge.

Mr. MARCHANT. Thank you, Mr. Chairman.

Mr. DAVIS OF ILLINOIS. Thank you very much.

Ms. Norton.

Ms. NORTON. Thank you very much, Mr. Chairman. I appreciate this testimony.

I am interested in an overarching and I think obvious question, in light of the fact that the Post Office is here, we in Congress are quite pleased to look past, and that is whether essentially this model gives the Postal Service today a mission impossible. First of all, we are dealing with a model that we enacted, we passed in 1970, and of course, we updated the act most recently, and very recently have updated it.

But I have trouble finding any precedent for the model we are dealing with. And I am very interested in your ideas on planning. I would like to know if you can think of any comparable model that, for example, presents the kinds of issues that have come before us. The Postal Service has been told to meet the same conditions that private mailers meet. We told them to do that in 1970.

Think of what 1970 was. It was pre-technology, no one even envisioned that there would be a faster, cheaper, way to communicate. If you decide to cut out even one post office some place, it is a major issue in that community, and Members of Congress will join the community in saying, you had better not do it. Yet the Postal Service has had some success in fighting through that. We think they will perhaps have more success. Nevertheless, as an example, that is an 18th century model.

Much of the Postal Service still is a model from this original act passed, setting up the Post Office of the United States of America, and it came in controversy, came before this committee on outsourcing, major issue. Because postal workers, for reasons that range from security reasons to their own employment object to what looks like creeping outsourcing. Private mailers don't have that problem.

Even the Congress will take on the Postal Service on something that it recognizes that half the time across party lines we don't even recognize. While I recall a few years ago when the Postal Service did what every big private corporation does and got sponsorship of the Olympics, and so it was the Postal Service logo. Members of Congress, I am telling you, Republicans as well as Democrats, came forward and said, what in the world are you doing sponsoring the Olympics? You know, gone from everybody's brain was the notion that this is what private corporations do, and they don't do it on a whim, they do market surveys.

We talk about major disruptions. Well, you know, private companies who go down the drain, we have had a major disruption of the worst kind here, everybody has to prepare for that. They have to prepare for it in a very special way, because nobody will accept we have had a major disruption if we can't deliver the mail.

The delivery times, each Member will hold the Postal Service accountable for delivery times within its jurisdiction. It is a major problem here even in the Nation's capital and this region. A number of years ago, they had to get their ducks in a row. We talk

about stakeholder input. There is lots to be said to that. The more you get of that, of course, the more demands there are going to be on the Postal Service of the kind that everybody's grandmama made, got to have Saturday delivery, got to have what we have always had.

And finally, of course, I mentioned the granddaddy of them all, whether you will think that the Postal Service is just a complete and total anachronism based on technological changes and a generation that increasingly doesn't even use newspapers other normal contraptions of modern society, but depends on technology.

I am interested in an overriding issue that one, whether there is any model like this in the world, and whether you think planning will overcome all of these obstacles. If I could name, the closest model I can think of is one that the Congress has completely rejected, and that is that while we have a railroad system that harks back to the 19th century, every modern society says if you want to have a railroad system and you have to have one and you want to have passengers, you have to massively subsidize it. Well, the United States says, hey, we are not going to subsidize Amtrak or anything else, you are on your own. And by the way, keep them running and modernize the thing. So we just look away from the obvious issues.

Well, you can do that on Amtrak and you will end up with what we have today and people get on planes, buses or whatever. On the Postal Service, the Congress won't tolerate it. At the same time, the Congress is saying, you do the same thing UPS does, you need to do the same thing FedEx does, you do it without one cent from us.

I for one find all this very intriguing, structurally and intellectually. But I need to hear from experts whether you think this is a model that can survive the ages.

Ms. SIGGERUD. Ms. Norton, those are a lot of questions. I will answer what I can. I have to say that I think your observations—

Ms. NORTON. It really is one question. I just gave you examples of what I think Congress just looks past and says, you all do it anyway, don't tell us, just do it.

Ms. SIGGERUD. I think your summary of the challenge was right on, that is that the Postal Accountability and Enhancement Act said the Postal Service, in fact, harkening back to 1970, the Postal Service should act as a business. This most recent act said that postage rates need to be held, of course, to the rate of inflation. But many stakeholders, including the Congress, have taken off the table a number of cost control options that the Postal Service could use to respond to that rate cap that you were mentioning.

Ms. NORTON. And you could depend on us not to put them back on the table. [Laughter.]

Ms. SIGGERUD. I guess I want to focus on the issue of, is there another model out there like that. Clearly, the Postal Service is the biggest post in the world, and handles a larger volume than any other country. But I want to focus my comments on this concept of the network that we have been talking about and the costs associated with that. The closest model that we have in the United States, to the challenges of right-sizing that network is really the BRAC approach, where there is in some excess capacity stakehold-

ers who want a variety of different things and indeed, to cut costs. To the extent that has been a successful approach, and there are differing views on that.

There are a couple of things that have been key to that. One is that the BRAC process set out principles, what are we trying to accomplish, what tools do we have. It named people that would be important for making those decisions and then it laid out a process for making decisions. Whether that is useful in thinking about the costs the Postal Service faces may be worth considering.

Ms. NORTON. By the way, that is a very interesting and intriguing thing, given the experience with BRAC, one wonders how far down the Postal Service would have to get before Congress politically embraced that model. But it is a very interesting and intriguing notion.

Yes, Mr. Milbourn.

Mr. MILBOURN. I have seen a couple of different models, one very close over a fairly extended period of time and the other just from some reading and research. But they both offer some lessons learned, I think. One is the Internal Revenue Service. I spent a fair amount of my career there, and both started there and then came back to it after the Reorganization Act of 1998. They had a modernization program and a restructuring program that was on two different levels.

One was to go from a regionally based structure to a taxpayer type or a customer type driven structure. That was actually a fairly easy thing to do. Commissioner Rosati took that bull by the horns and did a very remarkable job of reorienting the people of the IRS and the structure and some of the processes.

The very difficult part that they have been struggling with since I first worked there in the early 1980's is the issue of modernizing their computer systems. They have been attempting to modernize their archaic master file for 20 some years now, and are not dramatically close to finishing yet. And they have had a series of very extensive plans. But as the plan unfolds, and time passes, technology changes, the world changes around them, much as you were saying. So the plan has had to change and evolve over time. They have had to basically retrench along the way.

I think that is a key lesson learned. If you are having a long-term restructuring that you need to be flexible enough to be able to account for changes in the environment and new things that come at you over time.

The other model, and this is one I am far less familiar with, but some of the European posts, Deutsche Post, for example, it is my understanding when they embarked on a modernization project, and admittedly, it is dramatically smaller than what we are talking about here, they elected to do what amounted to shock therapy. They just re-did everything at once, re-did their processing, re-did their equipment. That is my understanding of it.

I don't see that the Postal Service could do something like that because of the enormous cost involved. But there certainly are some lessons learned, good, bad and indifferent, from taking that kind of approach.

Mr. DAVIS OF ILLINOIS. Thank you very much, Mr. Milbourn. We will go to Mr. McHugh.

Mr. MCHUGH. Thank you, Mr. Chairman.

Welcome. By way of editorial comment, I would say how much I know we all appreciate the continued efforts of both the GAO and the Inspector General. Over my 14 years of involvement in these issues, we have called upon GAO repeatedly to guide us and to assist us. This is the latest initiative, and we are always not just very happy but very much in need of your help and we appreciate that. As someone who had a little something to do with the creation of an independent inspector's office, a few bumps and grinds aside, I think it was a wise decision. We are seeing a little bit of that today.

Mr. Milbourn, I hope I didn't bob my head too hard in agreement as you were talking about what perhaps is one of the most profound and yet in its structure one of the most simple challenges the Postal Service faces, that is to cut costs but do it in a way that hopefully enhances service. Yet as I look through the GAO report, one of the more striking statements I saw, and probably because it was bold headline, but it is also in the text, was that USPS does not have a mechanism for determining AMP consolidation impacts on delivery performance. And then they go on to talk about there are some proxies, but proxies are not direct performance standards.

How do we help the Postal Service to develop that kind of process? And the second question is more rhetorical, how can you really go through a very necessary and yet critically dangerous process like the AMP without having some kind of performance standard measurement? Do you have any answers to that or suggestions, either one of you?

Mr. MILBOURN. I do think it has to be something on a global scale. In other words, I don't think that the Postal Service can approach individual AMPs from the standpoint of trying to set performance or service standards for that individual consolidation. To me, I tie this back to the requirements of the new act that says they have to do this kind of thing globally for the different categories of mail. Once they have that, then they have the criteria to use with each individual AMP.

What we have been finding in our reviews with the AMPs is simply the fact that they have to be very cognizant of and analyze what are the expected changes when they make a consolidation to the standards that they already have and ideally to future ones as they become established. And that needs to be a critical part of the decisionmaking on whether in fact to consolidate under any given AMP.

Mr. MCHUGH. Ms. Siggerud, any thoughts on that?

Ms. SIGGERUD. I would agree wholeheartedly with what Mr. Milbourn said. I think constructing some sort of delivery performance measurement approach AMP by AMP would be not a good use of the Postal Service's resources and probably not possible. We do need to look to this time down the road when the reporting standards and the new technology will make such type and measurement available.

Mr. MCHUGH. So we can, I think, all agree it needs to be system-side and that we don't really have the answers at the moment as to what those are. This is a work in progress, but—and I hope the Postal Service agrees—it is a work that has to be completed if you

are going to have an efficient evolution to a new model and one that enhances delivery performance, yes?

Ms. SIGGERUD. Yes.

Mr. MCHUGH. Well, that really, that was 4 minutes.

Mr. Milbourn, you talked about probably one of the best ways to de-conflict the process, and the gentlelady from the District of Columbia was talking about some of the challenges of having Congress involved. But probably the best thing we could do is tell Congress you can't contact the Postal Service, particularly in AMPs. I just had two go through it, and I will tell you, I wrote a few letters, and I am sure we all did.

But you talk in your testimony about reconciling what you defined to be the sometimes conflicting message, that is a very gentlemanly way of putting it, sometimes conflicting messages from influential stakeholders and mitigate their risk for possible to preclude paralyzing inaction. Boy, how can we do that, because that is a hard one.

Mr. MILBOURN. This is going to be really tough, because there are so many important stakeholders out there. There is of course Congress. But there are also mailers. And you and me receiving mail at our house are an important stakeholder.

I think the Postal Service needs to reach out very broadly to all possible groups to solicit this kind of input in an attempt to resolve these kinds of conflicting views. The question I think that will remain is, is it within the Postal Service's authority to elect to resolve some of these on its own, or will it be directed to do certain things irrespective of what seems to be the best business decision to make with all of the necessary input?

Mr. MCHUGH. Mr. Chairman, I should have left him alone, he wasn't paying attention to the clock. If I may, with your forbearance, just one what I hope will be a quick question. Ms. Siggerud, you spoke about, and of course, the topic here today is the mandate for modernizing service standards and measures. You talked about the PRC involving itself in their necessary work of developing regulations.

I am just curious, did you have a chance to assess the PRC's efforts there, or is that progressing in a sufficient manner, do you think?

Ms. SIGGERUD. We have not assessed the PRC's efforts in this area at this time.

Mr. MCHUGH. Thank you, Ms. Siggerud. Mr. Milbourn, I don't expect you have an opinion on that?

Mr. MILBOURN. No, sir.

Mr. MCHUGH. OK, thank you.

Thank you, Mr. Chairman. I told you it would be brief.

Mr. DAVIS OF ILLINOIS. Thank you both very much. We may have some additional questions that we would like to submit to you in writing. But given the fact that we've got three panels, we will proceed and thank you very much for your testimony.

While we are getting ready to seat panel two, let me just acknowledge that we are always pleased to have present former Members of Congress who have deliberated long and hard on these issues. I see that former Representative William Clay. Sir, we are delighted that you are here. Thank you.

While you are being seated, I will go ahead and introduce the witnesses. Panel two is Dr. John Waller, who has been director of the Office of Rates, Analysis and Planning of the Postal Regulatory Commission since February 2005. His primary responsibilities are directing the technical advisory staff of the Commission in supporting the commissioners in all proceedings and the development of commission reports.

Mr. William P. Galligan was named senior vice president of operations in May 2005 and reports to the Deputy Postmaster General and Chief Operating Officer. Mr. Galligan has responsibility for the Postal Service's engineering facilities, network operations management and delivery and retail functions.

Gentlemen, we welcome you both and thank you very much. If you would stand and raise your right hands.

[Witnesses sworn.]

Mr. DAVIS OF ILLINOIS. The record will show that each one of the witnesses answered in the affirmative, and we will begin with Dr. Waller.

STATEMENTS OF JOHN D. WALLER, DIRECTOR, RATES, ANALYSIS AND PLANNING, POSTAL REGULATORY COMMISSION; AND WILLIAM P. GALLIGAN, SENIOR VICE PRESIDENT, OPERATIONS, U.S. POSTAL SERVICE

STATEMENT OF JOHN D. WALLER

Mr. WALLER. Thank you, Mr. Chairman. Thank you for the opportunity to be here today.

My remarks are based on the Commission's 2006 proceeding on the evolutionary network development plans of the Postal Service. A copy of the Commission's opinion is attached to my full written statement.

The Commission endorses the Service's goals to create a more efficient and flexible postal network that realizes cost savings while maintaining service standards. The Commission also recognizes both the value of using modern, computerized optimization and simulation techniques to identify mail processing facilities for consolidation and the need to conduct site-specific reviews of individual facility consolidation plans as a reality check on the outputs of the computer models.

However, the Commission's analysis identifies significant problems that could result in a less efficient network with slower service. For instance, the emphasis on consolidating operations from smaller plants into larger ones, rather than consolidating from less productive plants into more productive ones. Focusing on more productivity holds more promise.

Transportation was not adequately considered in the END plants. It was not clear how nationwide transportation would be realigned, since the backbone of the network, the regional distribution centers, is shrouded in uncertainty. The Postal Service estimated there could be anywhere from 28 to 100 such centers.

At the local level, only 6 of the 17 of the consolidation plans reviewed by the Commission revealed estimated transportation cost savings.

As of last year, network development plans did not consider the significant changes in mail processing and transportation that will occur with the introduction of the flats sequencing machines. These machines are huge, expensive and were not incorporated in the planning models.

The Postal Service recognizes that its network redesign program could have a significant impact on service. However, in the proceeding, it did not provide a reliable estimate of the volume of mail that would experience either a downgrade or an upgrade in days to delivery. Nor did it estimate how often the Postal Service would need to move up collection times from the blue boxes or require earlier bulk drop-offs at their plants in order to meet performance standards. Nor did it provide information on the impact consolidations might have on time of delivery during an individual day to the homes and businesses.

The Commission also found problems in faulty assumptions in the computer models; in particular, not using actual mail processing productivity and cost characteristics. Instead, the models assumed idealized operations that ignore currently wide disparities in productivity among plants.

There is also assuming that unit costs decrease as plant sizes increase and this conflicts with evidence presented to the Commission. The site-specific development evaluation problems included lack of consistency in review procedures, lack of criteria for approval or disapproval of proposed consolidations, lack of public and mailer input and a severe tardiness in errors and analysis in the post-consolidation reviews where the Postal Service would learn as it goes forward.

While changes have been made and were made during the time of the proceeding, it was questionable if flaws have been remedied, particularly given the GAO report that has just been released.

In closing, let me emphasize that the Commission believes that the Postal Service should have the flexibility and authority to adjust its operations and networks to meet its business needs and create cost savings and efficiencies. However, the Postal Service must be accountable and transparent to all postal customers and be sensitive to the needs of the communities it serves.

Thank you. I will be pleased to answer any questions you may have.

Mr. DAVIS OF ILLINOIS. Thank you very much, Dr. Waller.

Mr. Galligan.

STATEMENT OF WILLIAM P. GALLIGAN

Mr. GALLIGAN. Good afternoon, Mr. Chairman, Ranking Member Marchant, members of the subcommittee. I am pleased to be with you today.

As senior vice president of operations for the Postal Service, I am responsible for engineering, facilities, delivery and retail operations and most relevant to our discussion today, network operations. There is a close and inter-dependent relationship amongst these activities. They have a strong influence on the viability of our network.

Ultimately, our service standards and ability to meet them are based on the effectiveness of the network. I look forward to discussing both of these important issues with you.

It is important that we view them within the context of the Postal Accountability and Enhancement Act, which was enacted last December. The law resulted in major changes that affect not only the Postal Service, but the entire mailing industry. One of the most significant changes is the requirement that price adjustments for our market-dominant products cannot exceed annual growth in the consumer price index. These products represent 90 percent of our business.

Unfortunately, some key cost drivers, such as energy and health care benefits regularly exceed CPI growth. With this requirement, the challenge for the Postal Service is to reduce costs and increase productivity, while providing high quality, affordable, universal service to our Nation. One approach we are pursuing is the examination of our processing and distribution and transportation network. Today's network is a product of an evolutionary process that began when our system was created over 230 years ago. It expanded to serve a Nation that was growing in population and territory. This infrastructure was adjusted over time to accommodate steadily growing mail volumes, the latest trends in transportation technology and specialized facilities to achieve greater efficiency.

In 1970, more than 2,000 facilities performed outgoing mail processing. Today, the number is less than 400. But in view of changes in mail volume, and the types of mail entering our system, we must continue to make our network even more efficient and capable of satisfying our customers' needs. Since 1998, single piece, first class volume has declined by almost 14 billion pieces, or 25 percent. This erosion continues by 1.5 billion pieces each year. Without offsetting system adjustments, this volume erosion reduces network efficiency and negatively affects our bottom line.

We have also seen a growing shift to pre-sort mail which enters our system much closer to its final delivery point. In 1970, virtually all mail moved in and through our system. Today about 40 percent of the mail we handle no longer requires end to end transportation. This decline in single piece first class mail and the entry of more mail deeper into our system means that our network is not aligned with current and future needs. Excess mail processing and transportation capacity drives up unnecessary costs and challenges our ability to operate within the statutory limits of a rate cap.

As Postmaster General Potter testified here last week, our challenge is to close the gap between prices and costs while maintaining quality service. He explained that management could proceed along any of three paths. The first is continuing status quo, which is obviously unacceptable. The second path is extensive contracting out of work now performed by our employees. But this could undermine labor-management and employee relationships that are so important to contributing the excellent service we provide our customers every day. We prefer a third path, working cooperatively with our stakeholders to confront the critical issues we are facing as an organization and as an industry.

The continuing modification of our network to reduce duplication, increase efficiency, accommodate new equipment and meet chang-

ing needs of our mailers is a strategy we are pursuing along this path. Network adjustments have contributed to our ability to achieve record levels of service, customer satisfaction and unprecedented levels of productivity. Based on more recent stakeholder input, we have been working to improve our business processes related to implementing network changes. These include expanded public notice, expanded public input and increased transparency.

Through all of these changes, we remain committed to our customers by maintaining overall service responsiveness and to our employees by not laying off a single career postal employee. The new postal law also requires us to develop modern service standards and related measurement systems. Together with a large and diverse group that represents all elements of the mailing community, we are working to identify what changes may be warranted. We are on target to complete this process next month. We are already consulting with the Postal Regulatory Commission so that new service standards can be published by late December.

In developing measurement systems, we are exploring the possible use of our intelligent mail bar code as part of an information platform that will allow us to leverage internal passive data collection to efficiently measure actual service performance.

We look forward to working with our stakeholders, particularly the Postal Regulatory Commission, in achieving agreement on revised service standards and measurement systems. I appreciate having the opportunity to discuss these important issues with you today and I would be pleased to respond to any questions you may have.

[The prepared statement of Mr. Galligan follows:]

UNITED STATES
POSTAL SERVICE

STATEMENT OF
SENIOR VICE PRESIDENT, OPERATIONS
WILLIAM P. GALLIGAN
SUBCOMMITTEE ON FEDERAL WORKFORCE, POSTAL SERVICE,
AND THE DISTRICT OF COLUMBIA
OF THE
COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM
HOUSE OF REPRESENTATIVES
WASHINGTON, DC

JULY 26, 2007

Good afternoon, Mr. Chairman and members of the Subcommittee. I am pleased to be with you today. I will be discussing the Postal Service's continuing progress in effectively managing the evolution of our mail processing network to promote efficiency, manage costs, and protect the high levels of service it provides for our customers. I will also touch upon efforts to update our service standards and performance measurement systems.

My name is Bill Galligan. As the Postal Service's Senior Vice President for Operations, I have overall responsibility for engineering, facilities, delivery and retail operations, and, most relevant to our discussion today, network operations. There is a close and interdependent relationship between each of these activities which, ultimately, have a strong influence on the shape, effectiveness, and efficiency of our end-to-end operations.

Engineering is responsible for the development, deployment, and maintenance of the advanced mail processing technology that has made the United States Postal Service the most productive in the world. Engineering's efforts reflect a keen sensitivity to the ability of our existing facilities to accommodate state-of-the-art equipment, to the processes and work flows that contribute to achieving the most efficient equipment utilization, and to changes in mail usage patterns that will guide the development of future generations of equipment.

With a national processing, distribution, retail, and delivery network comprising almost 37,000 leased or owned sites, the Postal Service relies on its facilities group to identify, acquire, and maintain the buildings that provide optimal support for a wide range of specialized requirements, from the smallest Post Office to the largest mail processing center. An important goal of this group is securing facilities that provide the long-term flexibility necessary to accommodate changes to work flow, processes, and equipment that can occur over time.

Delivery and retail is responsible for development of the policies and programs that govern the operation of the nation's largest retail network and the delivery of 213 billion pieces of mail to more than 146 million households and businesses annually. Day-to-day operation of our retail and delivery units is the responsibility of our field operations organization, including our nine Areas and 80 Districts.

Network operations, through its ongoing partnership with each of these groups, is responsible for developing and maintaining an efficient and cost-effective national network of transportation, mail processing and distribution support. Managing these networks requires a constant adaptation to changing situations and requirements. These include shorter term adjustments arising from catastrophic events such as Hurricane Katrina, the anthrax crisis, and the 9/11 terrorist attacks. Longer-term structural adjustments can result from changing space needs; improvements in processing equipment; shifting population centers; mail volume fluctuations and declines; changes in mailer behavior, such as greater levels of presorting, and the deposit of mail deeper into our system; and the development of new strategies to improve efficiency and service.

In the simplest of terms, the role of network operations represents the core of a multi-step value chain. It begins with the local collection of First-Class Mail deposited into our system at Post Offices, street collection boxes, residential mail receptacles, or from community businesses, and its transportation to a centralized processing facility, generally called a plant. Commercial mailers with larger volumes usually deposit their mail right at the dock of the processing facility.

At the plant, stamped mail, a relatively small and declining percentage of our total mail volume, receives a cancellation and a postmark. The majority of mail, with paid postage represented by a printed permit or a postage-meter indicia, bypasses these initial operations.

Based on its characteristics and ultimate destination, the mail is then directed to different sorting operations. Mail for local delivery can be sorted to the delivery office, the various carrier routes within a delivery office, and the actual sequence in which mail is delivered on the route itself. This mail is later transported to the local delivery office for next-day delivery.

Mail for delivery to more distant points may be sorted by state, city, or three-digit ZIP Code prefix. For destinations with service standards that can be met by ground transportation, this mail is trucked to a destinating mail-processing plant. If standards cannot be achieved through ground transportation, First-Class Mail is flown to the destinating plant.

At the destinating plant, the incoming mail is commingled with other mail for similar destinations – whether generated locally or from longer distances – and sorted, as in our previous example, to the appropriate delivery office. From there, local transportation brings it to the delivery office for final delivery. Based on our established service standards – generally reflecting the distance from mailing to delivery points – non-locally-generated First-Class Mail is delivered on the second or third day after mailing.

Other types of mail, including bulk First-Class Mail, bulk Standard Mail, and Periodicals, normally experience some variation on this basic processing model. This may include movement through different types of processing facilities, and the bypassing of many Postal Service processing and transportation operations due to entry of mail as close to the delivery point as possible.

Our processing and distribution network, as it exists today, is the product of an evolutionary process that began when the system was created more than 230 years ago. Over that period, it expanded to serve a nation that was growing in population and territory. It adapted its infrastructure, from one that was developed to serve a largely rural nation, to one that was increasingly defined by its urban areas, and, in the years since the Second World War, to the rapid growth of suburbia and, more recently, “edge cities”.

In the earliest days of our system, when absolute and per capita mail volume was relatively low, postmarking and mail sorting occurred at each individual Post Office. In the mid- to latter-nineteenth century, mail volume growth began a sharp and steady increase. Among the causes were the rapid expansion of our economy, the establishment of uniform and affordable national postage rates, the introduction of the prepaid postage stamp, and the inauguration of carrier delivery service. The burgeoning mail volumes – and the fact that more mail than ever was traveling longer distances – made it increasingly impractical and costly to process and sort mail in such a decentralized manner.

In the larger cities, a new concept, the General Post Office, resulted in the construction of larger, multi-purpose facilities. In addition to providing local mail service, they also served as central mail processing points, achieving the economies of scale that were impossible to realize through a network of much smaller offices with only a small fraction of their capacity.

The General Post Office was often co-located with a city's main rail depot, providing unimpeded access to mail volumes that were carried by the railroads – which had become the nation's primary and fastest form of long-distance transportation. This avoided the delays resulting from congested urban street traffic in moving mail back and forth between a more distant railroad station and the Post Office.

While the rails transported bulk quantities of mail quickly, it still had to be processed when it reached the terminal Post Office. This changed with the establishment of the Railway Mail Service, permitting mail to be sorted in special cars as they moved along the route, with pouches dropped off for local delivery at intervening towns as the train sped through. Locally generated mail was picked up from towns on the route. By the time the train reached its terminal, mail that had been sorted along the way was commingled with other mail already sorted and quickly sent along to its destination, across the city or across the nation. By 1930, their peak year, more than 10,000 trains moved the mail.

Only 35 years later, this number was less than 200. And by 1977, the Railway Post Office – and for the most part, the commercial elements of our national passenger rail system – were history. One of the backbones of our processing and distribution system for a better part of a century, the railroads could not overcome the transportation advantages offered by progress in air transportation and a modern interstate highway system.

At the same time, a strong and growing economy altered consumer behavior substantially from the "make-do" Depression and war years. Decades of pent-up consumer demand resulted in levels of purchasing never before imagined. Increasingly sophisticated advertising and direct mail industries became critical links between consumers and sellers. And new financial tools, like consumer credit cards, offered an unheard of degree of flexibility to everyday buying activities. These activities resulted in a new reliance on the mail – for selling, shipping, and billing.

This contributed to a steadily-growing mail volume and the need to find more efficient ways to process mail volume that registered record growth year after year. Advances in mechanized mail processing and sorting made it possible to increase efficiency by concentrating resources – including new equipment and employees – at a fewer number of larger facilities that, because of their size, offered the flexibility necessary to accommodate new equipment.

At the same time, suburban growth placed new demands on developers, local governments, and the Postal Service to provide services to the families who were moving into new subdivisions far from the city centers. As the new communities were served by new and improved highways, new schools, innovative shopping centers, and of course, extension of mail delivery, demand for additional housing increased, creating more than a half century of unparalleled suburban and exurban development.

Mail volume continued its seemingly unstoppable growth. Coupled with suburbanization and the development of the automated processing equipment necessary to absorb burgeoning mail volume without sharply increasing staffing and compensation costs, the Postal Service took a new approach to mail processing.

In most cases, the existing General Post Offices could not readily accommodate the needed new equipment. Nor could their locations, most often in downtown areas, accept the vastly increased truck traffic necessary to bring mail to and from what had often become sprawling bedroom communities and more distant airports.

Over the last four decades a network of centrally-located mail processing facilities was developed and constructed, located to take advantage of the proximity of highways and airports. They were designed specifically to maximize efficient mail flow, equipment utilization, and the economies of scale generally not possible in smaller, older, multi-level facilities that were insufficient for the space needs of modern processing equipment and their supporting conveyor, containerization, and transportation systems. In some cases, these newer facilities could accommodate up to 200 trucks at a time, rather than the much smaller number, often no more than a dozen, possible in core city locations.

When the modern, self-supporting Postal Service was created by the Postal Reorganization Act of 1970, more than 2,000 facilities served as our primary, outgoing mail-processing locations. Today, that number has been reduced to less than 400. Most mail processed in our nation today moves through one or more of these facilities. In fact, virtually all mail generated in the cities and towns of America is today processed at a centralized mail processing facility, along with mail from hundreds of surrounding communities. This has been the practice for decades. It is the exception that locally-generated mail is processed at the local Post Office.

Our flexible network approach has allowed us to keep pace with the needs of a changing nation. It has supported improvements in process consistency, equipment standardization, the economies of scale, and the achievement of record service performance and customer satisfaction. But the fact that our network has evolved into the form it occupies today should not be taken to mean that this is its ideal configuration.

The key fact that must be taken into consideration as we examine the future of our processing and transportation networks is that the dynamics of the 21st century communications market have altered – forever – the basic assumptions of postal economics in a monopoly environment. The traditional postal monopoly, while it still exists as a matter of theory and law, particularly for what the Postal Accountability and Enhancement Act of 2006 terms our "market-dominant products," does not exist in actual practice.

The explosive growth of electronic communications and an intensely competitive package delivery sector have led to the diversion of messages, business and financial transactions, and packages from the mail channel. Competition exists for every piece of mail that moves through our system.

This has significantly slowed overall volume growth, with actual declines in some products, and resulted in shifts from higher-margin products such as First-Class Mail – which represents 50 percent of our revenue base – to products like Standard Mail, which make a lesser contribution. However, Standard Mail volume is not growing at a rate sufficient to offset the decline in First-Class Mail. And our projections give us no reason to believe that First-Class Mail volume will rebound.

In a practical sense, this means that mail volume growth can no longer match the historic trends of the last three decades. In fact, we are projecting an absolute decline of one billion pieces of mail during the current fiscal year. At the same time, we will incur the expense of expanding our delivery network to accommodate almost two million new homes and businesses each year. On average – even with the recent rate change – we are delivering fewer pieces of mail to each address and average revenue per delivery is decreasing.

The business model created by 1970's Postal Reorganization Act to sustain a self-supporting Postal Service had as its basic assumption that continued growth in mail volume would produce the revenue necessary to offset the costs of an ever-increasing delivery base. That model is broken because mail volume is no longer growing at a rate sufficient to sustain delivery expansion.

While the Postal Accountability and Enhancement Act does respond to the Postal Service's need for flexibility in key areas such as price-setting and product differentiation, it does not fix the broken business model. However, with its stress on our ability to balance costs and the prices we charge for our services, the Act severs the historic linkage between our revenue requirements and our rates. By law, we are now required to keep prices at or below the rate of inflation for market-dominant products, which represent over 90 percent of our revenue base. Unfortunately, our costs are not governed by this same standard and many, such as energy and health benefit costs, have been rising faster than the consumer price index.

This is not a formula for long-term success. The challenge is to close the gap between prices and costs while maintaining quality service. The question is, "How do you do that?" As Postmaster General John E. Potter testified before this Subcommittee last week, management can proceed along any of the following three paths.

The first is operating as we have been since the Postal Reorganization Act of 1970 created today's Postal Service. It is difficult to argue with the success that it has engendered, particularly in the areas of service and efficiency improvements, and moving from a heavily subsidized to a self-supporting organization that has met its financial "break even" requirement.

But the rate cap imposed by the Postal Accountability and Enhancement Act of 2006 has changed the ground rules. Taking a "business-as-usual" approach would conflict with our responsibilities under the new law: we no longer have the option of adjusting rates to compensate for rising costs. Managing responsibly means that our focus has to be on keeping overall cost growth at or below the rate of growth in the consumer price index.

A second path to closing the gap between our costs and our rates would be the wide ranging outsourcing of duties now performed by our own employees. From a balance-sheet perspective, this could have a considerable effect on helping to reduce our costs. But it does not come without other costs that could affect our business success by interfering with our focus on working together to provide our customers with the best service possible.

We prefer a third, more inclusive path, one that involves working cooperatively with our unions and other stakeholders. We believe this is the best way to understand and address the issues that affect all of us, such as growing revenue and reducing costs. Our collective experience and ideas can be greater than those of each of us individually, resulting in the best approaches to the challenges we are facing.

I believe this approach is directly applicable to the actions we have been taking in response to the changes that are – and will continue to be – affecting our mail-processing network. They involve changes in the mail volume and mail mix handled by our processing facilities, changes in how mailers prepare and tender their mail, and the acquisition of new technology designed to increase accuracy and efficiency.

Since 1998, the volume of single-piece First-Class letters entering our system has declined by almost 14 billion pieces, or 25 percent, and this erosion continues by about 1.5 billion pieces annually. This is a very disturbing trend, particularly when viewed within the context of the average daily mail volume of 700 million pieces that moves through our system. Without offsetting adjustments, this volume erosion reduces processing efficiency and negatively affects our bottom line.

Bulk First-Class, Standard, and Periodicals mail, because it is largely presorted, can bypass many of our processing operations, resulting in greater efficiency for the Postal Service. This is not the case with single-piece First-Class letters, which require far more handling as they move through our facilities, resulting in higher per-piece processing costs.

Our investments in high-speed canceling, barcoding, and sorting technology was intended to maximize processing and distribution productivity for this mail, minimizing processing costs and achieving optimum return on our equipment investment. However, in many locations this equipment is no longer processing the intended volumes, resulting in productivity declines, increased costs, and a diminished return on investment.

The erosion of single-piece First-Class Mail represents two trends in changing mail use, which affect our processing network. The first is the decline in total First-Class Mail volume, which fell from a peak of 107 billion pieces in 2001 to 98 billion pieces last year. The second is the shift on the part of many mailers from single-piece First-Class Mail to less-expensive workshare-rate bulk First-Class Mail. In 2005 alone, this shift resulted in a \$300 million revenue decline.

The growing shift to presort mail permits mailers to take advantage of rate incentives that encourage depositing this mail much closer to its final delivery point. In some cases, this mail is entered at the actual delivery office. In other cases, it may be entered at the local processing plant serving the delivery office. Either way, this mail bypasses most of our "end-to-end" processing operations, the plants in which they are located, and the transportation networks that link them together.

In 1970, virtually all mail was entered into our system where it originated – an acceptance facility in the vicinity of the location where it was prepared by the mailer. That has changed appreciably in the intervening decades, dramatically shrinking the use of our network. Today, approximately 40 percent of the mail we handle no longer requires end-to-end transportation. We expect this overall trend to continue.

Both the decline in single-piece First-Class letters and the entry of more mail deeper into our system means that our network, as it exists today, is not aligned with our current and anticipated future needs. The resulting excess mail-processing and transportation capacity drives unnecessary costs challenging our ability to successfully operate within the limits of a statutory rate cap.

Given this challenge, we cannot afford to let our processing operations become less productive, something that will occur if we maintain the shape of the current network. It is imperative that we reduce overhead costs sufficient to offset declines in mail volume and fundamental changes in how mail moves through our system. This is why we must have the ability to adjust our infrastructure to reduce excess capacity, duplicative processes, and their associated costs. These necessary system adjustments will contribute to our ability to keep cost growth at or below the rate of inflation, balancing the requirement that rate increases do not exceed the rate of inflation.

A third important factor in the continuing evolution of our network is the pending deployment of the latest generation of automated mail sorting equipment, the Flat Sequencing System, for non-letter-sized items such as catalogs, magazines, and larger envelopes. While we have been successful in automating major elements of our mail processing, support, and retail functions, the physical delivery of hard-copy mail is not automatable. But, as we have learned through the progress in letter-mail processing, we can increase delivery efficiency through the automated sorting of mail into the sequence in which it is delivered by our delivery carriers. Reducing carrier in-office mail-preparation time can increase the time available for actual mail delivery, allowing us to better manage the costs associated with serving a growing delivery base and better respond to the financial pressures of reduced revenue per delivery.

Extensive testing of the Flat Sequencing System (FSS) in a live-mail-processing environment in Indianapolis has been successful. Phase one of a multi-phase deployment will begin in 2008, with completion anticipated by 2010. To the greatest extent practical, our goal is to integrate the FSS into select, existing facilities, based on the level of delivery volume, rather than to burden our ratepayers with the expenses of leasing or constructing new facilities. However, because of the very considerable space needs of this equipment, adjustment or relocation of some other processing operations, in some cases to other nearby facilities, may be required.

Today's processing and transportation network is the product of a continuing evolution based on a wide range of factors that affect our business. And, as we have seen, those factors can and do change over time. By continually improving our distribution and transportation systems, we have been able to achieve and maintain record levels of service, and customer satisfaction and unprecedented levels of productivity.

Despite these successes, some concerns have been raised regarding recent efforts to consolidate some mail processing operations in a number of locations through our Area Mail Processing concept. These adjustments are due to the decline in single-piece First-Class Mail, advances in automated mail-processing and distribution technology, and a growing shift in the entry of mail to locations much closer to the final delivery point. These adjustments generally result only in the transfer of a limited number of operations from one facility to another, not in the closure of affected facilities.

By combining the processing of this mail from multiple locations to a single, centralized location, we can reverse the decline in equipment efficiency resulting from reduced mail volume and daily throughput. We can reduce maintenance costs as we limit the amount of equipment requiring service. We can reduce the costs associated with obtaining new equipment as existing, underutilized equipment can be redeployed where it can be better used. And by reassigning employees from the affected operations – consistent, of course, with our obligations to them under the collective-bargaining agreements with our unions – we can minimize disruption to our employees' lives.

The Postal Service has been pursuing the Area Mail Processing concept for over three decades. This program has made it possible to decrease the number of outgoing processing locations by 80 percent, to fewer than 400. Our efforts today are simply a continuation of that process, accelerated by the extremely sobering imperatives of a radically- and rapidly-changing business environment. Over the years, the move to Area Mail Processing has not resulted in the layoff of a single, career Postal Service employee. This is not about to change.

Many of our stakeholders have raised a number of valid concerns regarding our implementation of Area Mail Processing initiatives over the last two years. As a result, we have revisited our policies, which have not been revised in many years, to address these important issues. Our revised policies, which will be issued shortly, will include well-defined public notice and public input processes, and increased transparency. What will not change are our continuing efforts to provide a network infrastructure that is more cost-effective and service responsive overall.

We discussed the key elements of our strategy to increase the pace of the evolution of a more efficient network in our original 2002 *Transformation Plan* and its successor *Strategic Transformation Plan 2006-2010*. In 2003 the bipartisan President's Commission on the United States Postal Service, in its report *Embracing the Future: Making the Tough Choices to Preserve Universal Mail Service*, issued a strong endorsement of our goal of streamlining our distribution network to reduce costs, increase operational effectiveness, and improve consistency of service. As you know, in the Postal Accountability and Enhancement Act of 2006, Congress endorsed this aspect of the Commission's work and strongly encouraged the Postal Service to expeditiously move forward in its network streamlining efforts.

In planning for today's hearing, the Subcommittee has also expressed its interest in the Postal Service's efforts to develop modern service standards and to measure our performance against those standards. Both of these requirements were established by the Postal Accountability and Enhancement Act, which recognizes that sound adjustments of the Postal Service's processing and transportation network depend upon accurate service standards and performance measurement systems for our market-dominant products. In turn, greater network efficiency will be the primary driver behind better service performance in the future. We have undertaken a wide range of activities to comply with the requirements of the new law in this respect.

First, we are working with a diverse group of stakeholders to examine existing end-to-end service-standards for our market-dominant products. This is helping us to identify which standards may be candidates for revision, based on factors such as changes to business rules, actual network capabilities, or the growth of worksharing programs since current standards were first established. This will provide the baseline information necessary to determine if modifications to some standards are warranted.

Our efforts involve the participation of the Mailers Technical Advisory Committee, in a main workgroup that involves over 100 representatives from all elements of the industry. This workgroup includes the participation of the independent Postal Regulatory Commission and the Government Accountability Office. We have also surveyed more than 35,000 small businesses and residential customers to help guide the development of the new standards. Outreach efforts also include interacting with attendees of the National Postal Forum, the leading annual mailing industry trade gathering, and briefings to our employee unions and management associations.

We are on target to complete this review – which will include proposed new service standards – by next month. This will provide us with sufficient time for required consultation with the Postal Regulatory Commission prior to the publication of revised service standards by late December 2007.

Our goal in developing these standards is to meet the needs of our customers while building from a base that is within the reach of the capabilities of our system. And, as we establish full accountability in achieving the new goals on the part of our managers, we believe that fairness dictates that we compile a full year's baseline of performance data under the changed standards prior to linking their performance evaluations to the achievement of the new goals. As an organization, however, we will bring all of our efforts to bear on meeting the revised service standards as soon as they are effective.

Just as important as the establishment of the new standards is the development and implementation of measurement systems to determine our compliance in meeting the standards. This is a subject that is also being examined by the Mailers Technical Advisory Committee.

Our efforts include planning for the possible use of the Intelligent Mail platform for accurate service performance measurement. Leveraging this internal, passive data collection system will allow us to accurately measure aggregate performance data – rather than sampling. We believe this is ultimately in the best interests of our customers, who ultimately pay for service measurement through the price of postage.

Our innovative Intelligent Mail system uses barcodes that uniquely identify each piece of mail for purposes of sorting, identifying special services, performing diagnostics as we identify system "pinch points," and providing status data to mailers. From the perspective of a passive service measurement system, the Intelligent Mail barcode will permit us to identify when mail enters our system, track the mail as it moves through the network, and tell when it has been delivered. As we expand Intelligent Mail to different types of mail, it can be used to accommodate service measurement needs. We anticipate full implementation of the Intelligent Mail barcode for most commercial mail in 2009. The Intelligent Mail barcode contributes to enhancing the value of the mail for our customers, contributing to their business growth and success, ultimately helping the Postal Service to achieve its critical goal of revenue growth.

We look forward to working with our stakeholders, particularly the Postal Regulatory Commission, in achieving agreement on the issues of revised service standards and measurement systems for our market-dominant products.

I appreciate having the opportunity to discuss these important issues with you today. I would be happy to respond to any questions you may have.

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Mr. DAVIS OF ILLINOIS. Thank you gentlemen very much.

Mr. Galligan, I think you present a rather comprehensive look at some of the problems and difficulties which the Service is facing, especially when you talk about the decline in first class mail and decline in the number of pieces of mail that there is to be delivered. Given these difficulties, or given these realities, redesigning and streamlining the postal infrastructure has been under consideration for quite some time. When you consider service to customers, the needs of mailers, the future impact of automation, and the entire environment in which you are working, what do you envision the new network looking like? And when would you see it sort of coming online in terms of saying, here is what we think it is really going to have to be?

Mr. GALLIGAN. Mr. Chairman, I think that in much of the discourse around this subject, we have to look at it from two different points of view. Our core competency as an organization is our network of delivery and retail facilities. That intact is a fundamental strength of our organization.

Our processing and distribution centers, that are world-class, with letter and flat automation and we are adding to that flat automation base as we move forward with the flat sequencing system, form the backbone of our future network. We also have an excellent air strategy that is part of that network, that moves mail in the air via two very competent suppliers and a select number of commercial airlines.

Where we are right now, I know it has been called unclear, but it is in fact part of a business concept that we are working through, is what do we do with our long-haul ground network and what has been called our bulk mail center network. We are working through market research on that effort, and certainly we intend to be out with our facilities plan in accordance with the new law by June of next year.

So my vision of the future at this point in time is we are certain that the erosion of first class mail continues. The consolidation of outgoing facilities continues on a very evolutionary scale. Our air network strategy is very clear. The work we are doing right now that will bring certainty to our total ground network and our bulk mail center network is still to be determined. It is a work in progress.

Mr. DAVIS OF ILLINOIS. You gave great credence to the relationships between all components of the system, that is, management and labor, working cooperatively together. What mechanisms do you have in place to solicit input from the unions and management associations relative to planning the new system or the new design?

Mr. GALLIGAN. We fully intend, as we move through examination of any business process, to communicate to our impacted organization, union organizations, what it is we are looking at, research and how that would play out. We have already been in communications, I personally, with leadership around where we are with our business concepts. These are not plans, these are not decisions. These are essentially steps forward for us to build a business case that will ultimately bring to fruition a full-scale facilities network plan for the U.S. Postal Service. I look forward to working with the

leadership of all impacted labor organizations to be very up-front in that regard.

Mr. DAVIS OF ILLINOIS. Dr. Waller, what are the PRC's views on the Postal Service's strategy for realignment that you have heard up to this point? How do you respond to what you have heard?

Mr. WALLER. Well, a lot of what we have heard is still similar to what was there last year. It isn't as if that much time has gone by. So a lot of the reactions are the same that are in the report.

It has just been pointed out that particularly the big hole is the BMC network, and what is the strategy going to be there for that. I think new initiatives are being pursued by the Postal Service, from what was just said, to try and firm that up. I think that is a useful move because you can't, unless you know what the backbone of the major transportation system is going to be, it is hard to adjust and say anything more than we said before.

I think some of the criticisms still hold. I don't know to the extent that they are going to revise their use of the models that were a part of the END process. But to the extent there, they do need some revisions to put in inputs that reflect more reality of what is going on out there in the field right now.

There is a great diversity in the performance among the plants. Until that comes before the Commission, a lot of times there is no explanation of why that diversity exists. It is just said to be fixed and persistent over time. Until some of those are understood better, it is going to be hard to understand how they are going to affect that ending up with a more productive network. Hopefully that will be taken care of, too, and they will have more realistic models if they continue to use that approach.

Mr. DAVIS OF ILLINOIS. Thank you gentlemen, very much. Mr. Marchant.

Mr. MARCHANT. Mr. Waller, you said in the last part of your testimony that the PRC has brought transparency to the postal network development plans. But the previous panel specifically said that was not the case.

Mr. WALLER. I think where we were when we started the case to where we were when we ended the case, when the case started and took a great deal of effort on the part of the people asking questions to find out exactly how many of the facilities were under consideration for modification, I think this enlivened the process very much, the review of them that has been going on then across the country right now.

We, I think through the asking of questions about the AMP process, got much more public input. There was a lot of forces causing that to happen. But as it became apparent, as the case started, that very little was out there in the public, including just what was the list of candidate facilities that had come out of all this modeling process, I think that helped add transparency. I think the AMP process did improve with more public input. But just identifying that was a need has, I think, been a value added.

Mr. MARCHANT. So you don't view the Government Accountability Office, do you view them as an adversary or as someone who is helping you?

Mr. WALLER. Oh, I think it is very useful. I think they endorsed and reiterated a lot of the conclusions that were in our advisory

opinion. I think there is a lot of similarity and they just picked it up and said, yes, in the few months that have gone by, not much has changed.

Mr. MARCHANT. I have a bulk mail facility in my district. When it comes to the bulk mail facilities, is that really a public input issue? Or are the retail facilities more of a public input?

Mr. WALLER. I think it is a public—any part of the node that mail is particularly dropped off, there are particular discounts that are for the BMCs. If you close or move them, people that are using them as an input are going to have to adjust where they, and it may be more expensive for them.

Mr. MARCHANT. So in this case, the public would be the retailers, the mailers.

Mr. WALLER. It would be retailers, it would be the local communities, too, that would be affected. I think the broader you set a net to get ideas, the better off you are going to be, because the more people are going to understand the needs. So I would say both the local community, the labor, people who understand the local issues. But in particular, the mailers that actually use it have to, I mean, it has been pointed out that the work sharing concept has evolved to a large extent.

Well, that is where now the mailers are doing a lot of the work previously done by the Postal Service and inserting it deeper into the system. Those insertion points are very critical, both to the mailer, what kind of service are they going to get at that insertion point, etc., and if you start mixing those up, you have to examine the impact it is going to have on them.

For instance, I would assume that there are a lot of possibly mailers near you, consolidators near your center who have built infrastructure themselves. So it is not just the Postal Service that would end up changing. There would be changes within the mailers who would use it. If they can't continue to use it in an efficient way, then the system itself overall is not going to get more efficient. So it has to be considered as not just what is happening to the Postal Service, but what is happening to the people who insert mail into the system and then how fast it gets to the people who are receiving the mail.

Mr. MARCHANT. Well, and every 2 years, all of us have the opportunity to get into the bulk mail business. [Laughter.]

Especially in media markets like Dallas, where that is the only affordable way to communicate, whether it be campaign or MRA. So it is a vital interest to all of us. But yes, my district is surrounded, DFW Airport. So yes, the bulk mail people have located there, J.C. Penney, all of the major mailers.

I appreciate your efforts. Thank you.

Mr. DAVIS OF ILLINOIS. Thank you very much. You mean television is too—

Mr. MARCHANT. For my district it is. [Laughter.]

Mr. DAVIS OF ILLINOIS. So you can't be doing much of that.

Let me just ask an additional question or so. Mr. Galligan, nobody likes to mention or make reference to, but I did note that Mr. Milbourn in his testimony did suggest that there might be times when you might have to look at the appropriateness of 6 day deliv-

ery in some instances, or some places. Is there much thought or conversation given to that kind of thinking?

Mr. GALLIGAN. I know Congresswoman Norton mentioned mission impossible. I don't share that we are on a mission impossible course, but it is a mission challenged. My personal opinion, and I think it is shared by our Postmaster General, is that the issue of 6 day delivery cuts to a public policy debate that goes to the notion of universal service.

I can assure you that organizationally, in my delivery and retail organization, we are not preoccupied at this point in time with any notion around changing our days of delivery to a 5-day model or an every other day model. There would be a point in time where our cost burden against the top line revenue is so out of whack that needs to be considered. I think it is a matter of public policy debate. I think it would cut through to the very notion of the mail monopoly and universal service.

And not to pass a monkey off my back, Mr. Chairman, but I kind of think that issue would probably fall up to your Chair.

Mr. DAVIS OF ILLINOIS. Well, I think it is something that certainly some people give thought and consideration to. And I think it is something that we have to be cognizant of. I will agree with your initial assessment that there are no simple solutions to very complex problems. There are complexities which do in fact exist. I think what we all want to do is try and make sure that we have a viable Postal Service that does in fact embody the principles of universal service and the principles of work opportunities and all of those things that we have come to know it as being.

So let me thank you gentlemen for your testimony. I am sure we will be continuing to look at all of that.

Let me also just indicate that Congressman Adam Schiff has questions that he would like to submit as part of the record to the Postal Service for answers. Without objection, that will be so ordered.

Gentlemen, thank you very much. We appreciate your being here.

While our third panel is being seated, I will go ahead and introduce them. Panel three, Mr. Michael Winn, has served as the director of postal operations for R.R. Donnelley, who is a member of the Association for Postal Commerce. Mr. Winn has been active in many printing industry associations and has been a member of the graphic arts industry for over 30 years. I might also indicate that R.R. Donnelley is one of the major business operations in my congressional district. We are indeed pleased and delighted to have them.

Mr. Robert E. McLean has been the executive director of the Mailers Council since 1996. He furnishes management services for the non-profit advocacy organization, serves as its public spokesman and represents the Council on Capitol Hill.

Mr. Jerry Cerasale joined the Directing Marketing Association [DMA], in 1995. As senior vice president, Government Affairs, he is in charge of the DMA's contact with Congress, all Federal agencies and State and local governments.

And Mr. Timothy May serves as general counsel and postal counsel to mail order companies, mailer associations, publishers and or-

ganizations of postal employees, including the Parcel Shippers Association, the National Association of Postal Supervisors, NetFlix and Capital One.

Gentlemen, welcome. And if you would rise and raise your right hands.

[Witnesses sworn.]

Mr. DAVIS OF ILLINOIS. The record will show that each one of the witnesses answered in the affirmative. And welcome. Mr. Winn, we will begin with you.

STATEMENTS OF MICHAEL J. WINN, DIRECTOR OF POSTAL AFFAIRS AND MAILING OPERATIONS, R.R. DONNELLEY; ROBERT F. MCLEAN, EXECUTIVE DIRECTOR, MAILERS COUNCIL; JERRY CERASALE, SENIOR VICE PRESIDENT, GOVERNMENT AFFAIRS, DIRECT MARKETING ASSOCIATION, INC.; AND TIMOTHY J. MAY, GENERAL COUNSEL, PARCEL SHIPPERS ASSOCIATION

STATEMENT OF MICHAEL J. WINN

Mr. WINN. Thank you, Mr. Chairman.

Mr. Chairman and members of the subcommittee, thank you for providing me this opportunity to testify on behalf of the Association for Postal Commerce [PostCom]. I am a member of PostCom's board of directors and the executive committee of the board. On behalf of PostCom's membership, we appreciate the opportunity you have provided PostCom to submit our views on the significant postal issues that you are examining in this hearing.

PostCom's membership consists of businesses and organizations, large and small, that use the postal system to communicate with their customers, donors and constituents. PostCom membership also includes the printers, logistics companies, fulfillment houses, software providers and others to make use of the postal system possible. Collectively, our membership is estimated to account for in excess of 70 percent of all the revenues the Postal Service receives from the standard mail sub-classes.

But our interest in the postal system goes far beyond these sub-classes. It is estimated that PostCom members accounted for about 50 percent or more of the total volume of catalogs weighing over one pound, books, audio and video materials and parcels that the Postal Service handles each year. Our membership also makes extensive use of first class mail and of both domestic and international shipments handled by alternative service providers, such as UPS, FedEx and DHL. PostCom thus has a vital interest in assuring the existence of an efficient, responsible, financially stable and competitive Postal Service.

My company, R.R. Donnelley, is the largest printer and postal logistics provider in the United States. As a mail service provider, we work with our customers to prepare enormous amounts of mail in all classes: periodicals, catalogs, parcels and letter mail. R.R. Donnelley produces a very significant portion of the mail pieces that are processed by the Postal Service and provides logistics for even more.

The passage of the Postal Accountability and Enhancement Act was a critical step to enable the Postal Service to address the dif-

difficult issues that it confronts in the current market environment. The Postal Service faces the continued expansion of postal delivery points, which increases its costs and at the same time, a decline in the rate of growth of mail volume, which adversely affects revenues.

With the passage of this act, Congress altered the regulatory framework in a comprehensive manner that strengthens regulatory oversight and enhances transparency, while providing the Postal Service the necessary management incentives to meet these challenges through greater operational efficiency and high quality service standards. PostCom supported the passage of the Postal Accountability Act and we are deeply grateful for the hard work that this committee put into that effort.

Mr. Chairman, we submitted detailed written testimony, so I will give a summary today. First, on postal realignment or END, Evolutionary Network Development, PostCom members support the realignment of the network, because we need an efficient, cost-effective method of delivering our message to the consumers. However, there is room for improvement in the way the realignment process is operating. That is really around communications.

The ultimate objective of the network redesign is to have an efficient network based on the needs of delivery, the new automation that is being deployed to efficiently process the mail, and to control costs. However, if it is done without a proper communication plan, which any good business should have, it is going to be incurring costs that are unnecessary. I will give you an example.

If we do not have a transparent view of how the network is going to be realigned, as logistics providers, we quite often have trucks redirected in transit from one facility to another. Our customers make mail plans to meet in-home dates months, sometimes weeks in advance. So we depend on the communication from the Postal Service as to where we are going and how to most efficiently get it there. Redirections increase costs and possibly even create delays for our customers.

Let's talk about another thing under the banner of network realignment, and that is, as the Postal Service is deploying new automation and changing the mail preparation requirements that are put on mailers and mail service providers, we have to be careful not to just shift costs out of the Postal Service out of the private sector, we look at total system costs to our customers, the mailers, as the correct way to be realigning the network and changing requirements for mail preparation and delivery.

A little bit on service standards. Service standards are absolutely vital to the mailers, along with good measurement and reporting. The reason is that an entire business decision is based on an in-home date. A mailer needs to know when their message is going to reach the consumer, so they can respond accordingly. I will give you two brief examples. Periodicals, subscribers buy periodicals because they expect to receive the periodical at a certain time. If that is not maintained, it is very likely that the subscriber will not re-subscribe. So the business decision there is, how do you produce the periodical with a dependable service standard and measurement to reach a certain in-home date.

Even more challenging is on the side of the catalogs. Catalogs start with an in-home date and from there they develop their mail plan, when they are going to drop the mail. From there, they tell their printer when they are going to be able to print. Then there is a decision on the inventory and the content of that catalog. Coordinating the in-home date with inventory on hand and a staff call center is the challenge. And it all stems from service standards with critical entry times.

Critical entry times can also be affected by the automation that is being deployed. If that changes, we need transparency in seeing how that is going to change, so we can adjust our mail plans and other planning accordingly.

In conclusion, I would like to thank you, Mr. Chairman, and the subcommittee, for allowing me to testify today on behalf of PostCom. We appreciate your accepting of our written testimony.

[The prepared statement of Mr. Winn follows:]

**BEFORE THE
SUBCOMMITTEE ON FEDERAL WORKFORCE,
POSTAL SERVICE AND THE DISTRICT OF COLUMBIA**

**Testimony of Michael J. Winn on Behalf of the Association for Postal Commerce
July 26, 2007**

Introduction

Mr. Chairman and members of the Subcommittee, thank you for providing me with this opportunity to testify on behalf of the Association for Postal Commerce, also known as PostCom. My name is Michael Winn, and I am Director of Postal Affairs and Mailing Operations for R.R. Donnelley. I am a member of PostCom's Board of Directors and the Executive Committee of the Board. On behalf of PostCom's membership, we appreciate the opportunity you have provided PostCom to submit our views on the significant postal issues you are examining in this hearing.

PostCom's membership consists of businesses and organizations -- large and small -- that use the postal system to communicate with their customers, donors and constituents, and the printers, logistic companies, fulfillment houses, software providers and others that make use of the postal system possible. Collectively, our membership is estimated to account for in excess of 70% of all revenues the Postal Service receives from the Standard Mail subclasses, but our interest in the postal system goes far beyond these subclasses. It is estimated that PostCom members account for about 50% or more of the total volume of catalogs weighing over one pound, books, audio and video materials, and parcels that the Postal Service handles each year. Our membership also makes extensive use of First-Class Mail, and of both domestic and international shipments handled by alternative service providers such as UPS, FedEx, and DHL. PostCom thus has a vital

interest in assuring the existence of an efficient, responsive, financially stable, and competitive Postal Service.

R.R. Donnelley is the largest printer and postal logistics provider in the United States. As a mail service provider, we work with our customers to prepare enormous amounts of mail in all classes – periodicals, catalogs, parcels, and letter mail. R.R. Donnelley produces a very significant percentage of all the mail pieces processed by the United States Postal Service, and provides logistics for an even larger percentage of all mail pieces processed.

The passage of the Postal Accountability and Enhancement Act (“PAEA”) was a critical step to enable the Postal Service to address the difficult issues that it confronts in its current market environment. The Postal Service faces the continued expansion of postal delivery points, which increases its costs, and at the same time a decline in the rate of growth of mail volume, which adversely affects its revenues. With the passage of this Act, Congress altered the regulatory framework in a comprehensive manner that strengthens regulatory oversight and enhances transparency, while providing the Postal Service with the necessary management incentives to meet these challenges through greater operational efficiency and high quality service standards. PostCom supported the passage of the PAEA and we are deeply grateful for the hard work that this Committee put into that effort.

Network Realignment/Evolutionary Network Development

The Postal Service has adopted goals to develop mail processing and transportation networks that are suited to current and future operational needs, to reduce inefficiency and redundancy, to make operations flexible, and to capture the resulting cost savings. While these goals may be designed to reduce costs, they are, plainly, not designed to eliminate jobs. A logistics network such as the Postal Service's must evolve

to meet changing operational demands. These changes are designed to make the Postal Service work smarter, not harder. PostCom strongly supports the Postal Service's network realignment goals.

However, there is room for improvement in the manner in which the Postal Service carries out its network realignment plans. This is not a one-way street. Just as PostCom members need a Postal Service that operates as efficiently and cost effectively as possible, the Postal Service needs the mailers and the mail service providers like Donnelley that drive the mail volumes and revenues that are the Postal Service's lifeblood. The ultimate objective of network realignment, as we view it, is not to enable the Postal Service simply to achieve the lowest possible cost of operation that it can. The objective of network realignment must be aimed at achieving the lowest combined cost of the Postal Service and the mailing community.

First, there must be improvement in the interaction between the Postal Service and the community it serves. This simply has to do with communication of information about network realignment by the Postal Service. While the Postal Service is a public agency, it is also a business, and like any business, the Postal Service cannot operate in a fishbowl. However, good business practices also demand an effective communications strategy. So, while complete transparency from planning stage to implementation may well be ill-advised, a reasonable amount of advanced notice to major mailers of operational changes is necessary so that mailers can anticipate how consolidation will affect us and our operations, and so that the effects of the transition on the entire postal industry (including the Postal Service) are minimized.

As the Postal Service implements its Evolutionary Network Development program, the current class-based network will be shifting to a shape-based network. Changes to the drop entry landscape will be occurring at a greater pace than ever before. Inadequate communication from the Postal Service about changes in its network poses serious problems for Donnelley and all PostCom members. For example, our trucks are too often redirected when they reach the postal facility to which they were told to bring mail. This results in delay in delivery and in added costs to the mailer. As the Postal Service implements changes, different drop locations are identified for different types of mail that have previously been consolidated on mailers' trucks for delivery to a single location. This, too, complicates an already complicated process. Mailers' costs also rise as the Postal Service makes changes to its processing facilities, removes old equipment and installs new equipment such as Flats Sequencing System (FSS) machines. All of these factors influence the results of a mailers' cost-benefit analysis of the mail.

There is a similar need for improved communication and care in the development of Postal Service rules and policies with respect to mail preparation – the manner in which printers and other mail service providers are required to sort and package and present their mail at Postal Service facilities. A recent example of this problem grew out of what PostCom members hope was the last rate case to be tried under the old statute. In that context, the Postal Service decided to more sharply define certain kinds of mail – particularly catalogs or other flats – apparently in order to achieve improved processing efficiency on its automated sorted equipment. To the Postal Service's credit, mailers were afforded the opportunity not once, but twice, to make their views on the changes known to the Postal Service. But the reality is that the Postal Service did not have a clearly defined plan in mind when it initiated the process and the result is that many of

the final, and very important details, about these new shape-based definitions did not become available until literally the last minute. The cost to the industry of bringing its business plans and operations into line with the Postal Service's last minute decisions were substantial. Regrettably, these costs emerge as diminished volumes to the Postal Service.

In short, early, well and thought-out clear information about near-term changes in the Postal Service's network and its mail processing equipment is essential to attainment of the network realignment goals.

Second, it is equally important that the Postal Service work much more closely with the mailing community than it ever has in the development of modernization plans. It weighs very heavily the needs and concerns of the mailing community in formulating its final decisions.

Too often in the past, Postal Service decisions concerning operational changes have been made in a vacuum – rules and policies are issued that may reflect what the Postal Service perceives to be in its best interest, but without adequate consideration or assessment of the effect of these operational changes on Postal Service customers. Several years ago, for example, the Postal Service became concerned – and properly so – about the extent of bundle breakage occurring on certain of its automated mail processing systems. Its solution was to abruptly and – frankly, arbitrarily – impose new and stringent “bundled integrity” requirements upon mail service providers and mailers; and these new bundled integrity rules were to be backed by the imposition of penalties. The problem with these requirements was that there was absolutely no evidence that even a

primary cause of bundle breakage was the result of inadequate or sloppy bundle preparation by the mailing community. Worse yet, the new standards were technologically impossible in some respects and far greater than what was legitimately needed in all respects. The issue was ultimately resolved to the mutual satisfaction of the industry and the Postal Service, but not without very substantial cost and time and effort on the part of PostCom and the industry.

Network realignment and modernization will not succeed unless the views and concerns and capabilities of the industry are taken into account. This does not mean that mail preparation and other standards imposed by the Postal Service on industry must be set at the lowest common denominator. But, by the same token, if the only or primary result of network realignment is to shift costs from the Postal Service to the private sector, the purpose of this process will not be realized.

Our common goal should be to encourage business mailers to sort, containerize and drop ship to the finest extent possible so that the Postal Service and the mailers can achieve the lowest combined costs of mail processing and delivery. We are confident that the Postal Service understands that maintaining or increasing mail volumes, and, through volumes, enhancing the Postal Service's earnings, depends on reducing the costs of a mailpiece from development through delivery, not just on reducing postage. Therefore, PostCom expects the Postal Service to evaluate its network realignment and operations with the perspective of lowest combined cost.

Service Standards and Performance Measurement

As you know, the PAEA established an administrative process for the development of service standards and a service performance measurement system. PostCom believes that the establishment of service standards and performance measurement reporting are inextricably intertwined. Meaningful standards are important, but meaningful standards without public reporting of actual performance is of very little value to mailers. Standards and performance measurement must be developed based on the needs of users of each product, balanced against Postal Service costs. And, precisely because the Postal Service is undergoing a technological and operational transformation, the Postal Service and the Regulatory Commission must not assume that the task of establishing service standards is a one-time event. As operational efficiencies are gained and as the lowest combined cost of services are realized, service standards must also be revised to reflect these new realities.

Service Standards

In PostCom's view, meaningful standards will recognize different service expectations with respect to various levels of presort, dropship, and containerization to enable mailers to make informed decisions with respect to the value of additional mail preparation and transportation prior to entry.

One of the important elements of meaningful standards is the relationship of Critical Entry Times to service. Critical Entry Times are the cut-off times used by the Postal Service to determine whether a particular type of mail is entered or arrives at a postal facility in time to make the necessary processing and transportation time lines to meet the service standard for that product. As PostCom pointed out in its comments on

service standards filed with the Postal Regulatory Commission in early July, Critical Entry Times and service standards are integrally linked: changing Critical Entry Times can equate to changes in service standards.

For example, if a postal facility moves the Critical Entry Time for Periodicals Mail earlier, any mail entered at (or arriving at) the facility after that Critical Entry Time would have an additional day added to its service standard, with cascading effects. Thus, Critical Entry Time data must be available along with service standards so that mailers can appropriately determine service expectations. Publishing and adhering to consistent Critical Entry Times enables mailers and mail service providers to adjust their schedules and thereby work in tandem with the Postal Service to advance delivery reliability consistent with the objectives of the PAEA.

Service Performance Measurement

Of course, establishing Service Standards without a mechanism for assessing performance in relation to those standards would be a meaningless exercise. Publicly available aggregate service performance measurement data is essential, not only to motivate the Postal Service to improve service, but to enable mailers to manage costs at their end. Aggregate performance data is required so that both Postal Service management and mailers better understand whether delivery standards are being met. The information can help us understand what factors are contributing to performance issues and how we should respond.

The importance of actual measurement data becomes clear when we examine the reasons why businesses like PostCom's members, use the Postal Service. Mail is not an end in itself. Businesses use the mail to convey information to the American public that individuals can act upon. Those actions range from managing their personal affairs,

ordering merchandise that they need and want, supporting the charities and other organizations to which they belong, to learning about matters that affect them in all aspects of their lives. In the mail, therefore, mailers must and do have sophisticated and carefully integrated business plans and processes that control their processes from inception to conclusion and are calculated to achieve the goal of the mailpiece in the most efficient manner possible.

Very often, the business plan of mailers starts with a targeted "in-home date." For example, catalog companies need to know exactly when their customer receives the catalog so they can have the proper inventory on hand, and their call center staffed to handle incoming calls. Service performance data would allow the catalog mailer to develop a plan that backtracks from the expected delivery date to develop catalog production and delivery schedules, and even inventory acquisition schedules. In the world of Periodicals, subscribers expect to receive their magazine on certain days, and when they don't, they complain. Again, aggregate service performance data would allow periodical mailers and mail service providers to plan mail entry and drop shipments better. Periodical customers will be more likely to renew their subscriptions if they can depend on receiving their information on a predictable and regular basis.

With the exception of First-Class mail, the Postal Service does not now consistently or regularly evaluate or publicize performance in relation to guidelines. To its credit, the Postal Service realizes that performance measurement systems must also be established for all of the market dominant products created under the PAEA. It has established a task force through the Mailers Technical Advisory Committee to work with mailers in the development

of systems of measurement that are useable by the mailing industry in the formulation of their business plans.

Service performance measurement systems/solutions must evolve as technology and industry practices change. The Postal Service also quite correctly observes that developments in Intelligent Mail, which involve barcoding and tracking mail through the postal system, will facilitate better performance measurement systems, but performance measurement cannot await widespread adoption of these new technologies. Technology and data that now exists could readily provide accurate measurement of delivery times for certain products, and – as with service standards – the system of performance measurement must be expected to evolve and improve as technology and operational improvements occur.

Conclusion

In closing, thank you again, for the opportunity to testify. PostCom hopes that this testimony will help the Subcommittee in its oversight of the implementation of the PAEA and we look forward to working with you as that process moves forward.

Mr. DAVIS OF ILLINOIS. Thank you very much.
Mr. McLean.

STATEMENT OF ROBERT E. MCLEAN

Mr. MCLEAN. Thank you, Mr. Chairman, Mr. Marchant.

The Mailers Council is the largest group of mailers and mailing associations in the Nation. We represent for-profit and non-profit mailers, both large and small, that use the Postal Service to deliver correspondence, publications, parcels, greeting cards, advertisements and payments. Collectively, the Council accounts for approximately 70 percent of all of the Nation's mail.

The Mailers Council believes that the Postal Service can be operated more efficiently, supports efforts at containing postal costs, and has the ultimate objective of lower postal rates without compromising service. We welcome this opportunity to testify on the creation of delivery service standards and performance measurement systems. These were issues of singular importance to mailers who lobbied for their inclusion in the Postal Accountability and Enhancement Act, the Postal Reform bill signed into law last December that many people on this dais had something to do with. Whatever differences mailers may have had on other sections of the bill, our members were and are unified in their support for standards and a meaningful performance measurement system.

There are several reasons why we are interested in new delivery standards. For many mail classes, the Postal Service today has delivery guidelines, not standards. And its measurement systems fail to measure the type of mail that compromises most of the volume it delivers.

Although Title 39 directs the Postal Service to operate like a business, in this area the Postal Service is doing quite the opposite. Private sector companies would not conceive of functioning without standards for one fundamental reason: setting standards and measuring the organization's success in achieving them makes the organization better. Only by measuring performance can an organization identify where problems exist and then correct them and reward managers for their improvements.

We believe that creating new delivery service standards and performance measurement systems can be done in a way that will satisfy mailers for four reasons. First, because of improvements in the technology found in every mail processing facility, much of the data needed to determine delivery performance already exists. Second, data collection for delivery measurement in classes that affect the larger mailers can be developed without large new expenses. Third, any additional cost would be an insignificant portion of the postal budget. And fourth, mailers will dedicate their time to working with the Postal Service to design these processes, because they will help make management more efficient and hold down postage costs.

As for the features we expect to see in the new delivery standards, they must be realistic and reliable. The Postal Service must avoid lowering existing service standards. We need new and more complete reporting of delivery performance as well. Mailers are interested in the speed and consistency of delivery. So we need a system that will tell us if the Postal Service is achieving both goals.

New delivery performance reports must be timely and detailed by geographic location. The Mailers Council opposes the concept of fining the Postal Service should it fail to meet delivery standards. Because the Postal Service receives 100 percent of its revenue from mailers, the imposition of a fine would actually be a fine on mailers.

The Postal Service's board of Governors must encourage the creation of new executive compensation systems that reflect management's ability to meet those standards. These systems must offer greater compensation where consistent, on-time delivery is met.

You also asked us to comment on the closing and consolidating of postal facilities. In its efforts to improve delivery performance and in response to ongoing changes in mail volume and composition, the Postal Service will need to consider consolidating some of its facilities. We will support the Postal Service in realigning its mail processing and delivery networks. We recognize that closing a postal facility is difficult, because it affects the lives of so many individuals. However, right-sizing the postal network is an essential step to keeping down the cost of postage. Therefore, we hope Members of Congress, including members of this subcommittee, will support such decision that are essential to improving postal efficiency nationwide.

Where consolidations have been handled successfully, postal managers communicated with mailers, employees and the public served early and often. They also allowed sufficient time to plan delivery and transportation changes. Where such consolidations have been handled poorly, postal managers have moved too quickly and failed to sufficiently discuss the implications with its customers, like Mike, and its employees.

The Mailers Council members have spoken with senior postal officials, including Postmaster General Jack Potter about how network realignment will be handled in the future. As a result, we are confident that mailers will be brought into discussions earlier and that we will be assured that managers in the field will have the resources they need to be able to implement such difficult changes.

Mr. Chairman, thank you again for this opportunity to represent our views on these important postal issues. We will gladly answer any questions you and your colleagues have.

[The prepared statement of Mr. McLean follows:]

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MAILERS COUNCIL

TESTIMONY BEFORE THE HOUSE SUBCOMMITTEE ON FEDERAL WORKFORCE, POSTAL SERVICE, AND THE DISTRICT OF COLUMBIA

JULY 26, 2007

TESTIMONY OF

ROBERT E. MCLEAN, CAE

ON BEHALF OF THE

MAILERS COUNCIL

Good afternoon, Mr. Chairman, and members of the subcommittee. The Mailers Council appreciates the opportunity to testify on postal issues. My name is Bob McLean, and for the past decade I have been the Council's executive director.

BACKGROUND

The Mailers Council is the largest group of mailers and mailing associations in the nation. We represent for-profit and nonprofit mailers (large and small) that use the United States Postal Service to deliver correspondence, publications, parcels, greeting cards, advertising, and payments. Collectively the Council accounts for approximately 70% of the nation's mail volume.

The Mailers Council believes that the Postal Service can be operated more efficiently, supports efforts aimed at containing postal costs, and has the ultimate objective of lower postal rates without compromising service.

We welcome this opportunity to testify on the Postal Service's creation of delivery service standards and performance measurement systems. We also comment on plans for closing and consolidating postal facilities.

DELIVERY SERVICE STANDARDS AND PERFORMANCE MEASUREMENT SYSTEMS

The need for delivery service standards and new measurement systems are exceptionally important issues for the Mailers Council, whose members include corporations, nonprofit organizations and major mailing associations that collectively account for approximately 70% of the nation's mail volume. Delivery service standards and performance measurement systems were issues of singular importance to mailers who lobbied for their inclusion in the Postal Accountability and Enhancement Act (PAEA), the postal reform bill signed into law last December. Whatever differences mailers may have had on other sections of the bill, our members were, and are, unified in their support for standards and a meaningful performance measurement system.

A number of our members have submitted class-specific comments to the Postal Regulatory Commission on the topic of delivery standards. As an organization whose members encompass every mail class, our comments will be more general and reflect areas of concern shared by the majority of our members.

There are several reasons why mailers are so interested in new delivery standards. For example, many mail classes the Postal Service has delivery guidelines, not standards, and its measurement systems fail to measure the type of mail that comprises most of the volume it delivers.

Although Title 39 USC directs the Postal Service to operate like a business, in this area the Postal Service is doing quite the opposite. Private sector companies—including postal competitors—would not conceive of functioning without standards for one fundamental reason: Setting standards and measuring the organization's success in achieving them make the organization better. Only by measuring performance can an organization, whether in the public or private sector, identify where problems exist—and then correct them, and reward managers for their improvements.

As problematic, current postal measurement systems monitor general attitudes of individual postal customers and the Postal Service's success in delivering their mail, typically single-piece letters and cards. This approach monitors only one category of mail and overlooks mail sent by companies that produce more than two-thirds of postal revenue.

We believe that creating new delivery service standards and performance measurement systems can be done in a way that will satisfy mailers for four reasons.

First, because of improvements in the technology found at every postal mail processing facility, we believe that much of the data needed to determine delivery performance already exists. The Postal Service may, in fact, already be collecting much of it, although failing to share the data with its customers.

Second, data collection for delivery measurement in classes that affect most of the Postal Service's largest mailers can be developed without large new expenses. It is true that the current measurement systems (External First-Class Measurement System and the Customer Satisfaction Index) are costly. However, that cost occurs because a third-party vendor must be engaged to collect the data. We believe the Postal Service could collect, and in most cases already is collecting, the data mailers need, using its own systems.

Third, if there are additional costs they would be due to additional work created for postal employees. Such costs, however, would be an insignificant portion of the postal budget.

Fourth, mailers will dedicate time to working with the Postal Service to design a process for setting performance standards and measuring the Postal Service's success in meeting them because such processes will help management improve its efficiency. That efficiency, in turn, will help hold down postage rates.

Of course, one of the biggest reasons why some postal officials are concerned with new delivery standards is that once set, mailers would expect them to be met. We recognize that consistently meeting delivery standards creates numerous operational challenges for postal managers. Meeting standards could be especially difficult in high-growth areas, where postal managers already struggle to add thousands of new deliveries annually. But without reliable, consistent deliv-

ery, mailers who have the option of using alternative media, or alternative delivery means, will leave the postal system—permanently.

Now that you can appreciate the importance of these issues to our members, let me next focus on the features we expect to see in new delivery standards and performance measurement systems.

Many of our members are working with the Postal Service on delivery service standards as members of the Mailers Technical Advisory Committee, or MTAC. In those meetings our members have told postal officials that regardless of the class of mail under discussion, we need standards that are realistic and reliable. We also have emphasized the need to avoid lowering existing service standards in any significant way. We may agree on limited service changes, but will strongly oppose major downward service redefinitions without independent review.

Once the Postal Service establishes new delivery service standards, we look forward to new and more complete reporting of delivery performance. Mailers are interested in both the speed and consistency of delivery, so we need a system that will tell us if the Postal Service is achieving both goals.

More specifically, new delivery performance reports must have several qualities, none more important than timeliness. Infrequent performance reports handicap mailers from protecting themselves by changing their mail entry times or locations, and allow regional service problems to evade public scrutiny.

The data must be detailed by geographic location. Moreover, the performance reports should indicate not only the average time for mail delivery between two points, but the distribution of the variance from standard for the portion of the mail that is delivered late (sometimes referred to as the “tail of the mail”).

We understand that there may be situations where high growth or other factors temporarily skew postal performance. Absent these situations, which we believe represent a small percentage of all postal operations, mailers deserve to know if they are receiving the service for which they are paying. Today, no business can succeed without measurement systems. We believe the same approach must be taken by postal managers.

The Mailers Council opposes the concept of fining the Postal Service should it fail to meet delivery standards. Because the Postal Service receives 100% of its revenue from mailers, the imposition of a fine would actually be a fine on mailers. There are better forums for addressing such problems, most notably oversight hearings such as this one.

The Postal Service’s Board of Governors must encourage creation of new executive compensation systems that reflect senior management’s ability to meet those standards. These systems must offer greater compensation where consistent, on-time delivery is met. The PAEA has given the Postal Service some additional and much-needed latitude in the way it compensates its managers. We strongly encourage the Board of Governors to use the results of any new performance measurement system in determining who will receive the additional compensation the PAEA makes possible.

CLOSING AND CONSOLIDATING POSTAL FACILITIES

In its efforts to improve delivery performance, and in response to ongoing and future changes in mail volume and composition, the Postal Service will inevitably need to consider closing and consolidating some mail processing facilities. The Postal Service has already begun this process, so far with mixed results. However, we believe such situations can and will be handled more efficiently in the future.

First, the Mailers Council will support the Postal Service in realigning its mail processing and delivery network. Given the number of new deliveries in many cities, and the changes underway in the mailing industry, alterations to the network are the best possible way of containing postal rates without compromising service—which is the Mailers Council's mission. Of course, these same changes may also require the construction of new facilities or the expansion of existing ones.

Any decision to close a postal facility is a difficult one because it affects the lives of many individuals. However, right-sizing the postal network as the mailstream changes is an essential step to keeping down the cost of postage. Therefore, we hope Members of Congress will support such decisions that are essential to improving the efficiency of the Postal Service.

Where consolidations have been handled successfully, postal managers communicated—with mailers, employees, and the public served—early and often. They also allowed sufficient time to plan related delivery and transportation changes. Where such consolidations have been handled poorly, postal managers have moved too quickly and failed to sufficiently discuss the implications with its customers and employees.

The Mailer Council's members have spoken with postal officials at the highest levels, including Postmaster General Jack Potter, about its network realignment, expressing our concerns about how it will be handled in the future. As a result, we are confident that mailers will be brought into the process earlier, and that field managers will receive the time and resources needed to manage such difficult yet necessary changes. We believe mailers will be kept informed consistently so that we can plan changes to our own systems accordingly.

Mr. Chairman, thank you again for the opportunity to present our view on these important postal issues. I would gladly answer any questions you and your colleagues may have.

Mr. DAVIS OF ILLINOIS. Thank you very much.
Mr. Cerasale.

STATEMENT OF JERRY CERASALE

Mr. CERASALE. Thank you, Mr. Chairman, Mr. Marchant. It is a pleasure to be here. Thank you for inviting the DMA to give our comments on this important matter.

I am Jerry Cerasale, the senior vice president for government affairs for the DMA. DMA is an association, the largest American association of multi-channel marketers, using the mail, internet, television, radio, telethon, to reach customers and potential customers, and also those who support those marketers. Mail is an important cog in the direct marketing industry in the United States, which has an effect of over \$1.4 trillion on the American economy.

The Postal Service needs flexibility in order to create an efficient transportation, sorting and delivery network. We support the Postal Service in those efforts and we supported the Reform Act giving the Postal Service management those tools to try and reach an efficient system. But we cannot and we must be vigilant against allowing realignment to become a hidden rate increase, a rate increase to mailers beyond the CPI cap.

I will give you a couple of examples. One, change the time of delivery for bulk mail to a facility from 6 p.m. to 6 a.m. Think about a magazine that is necessary to get information out quickly. That is a huge cost to them, because that eliminates an entire day. They have to change their entire operations.

Think about changing where you have to drop ship your mail. An example, an absurd example, but interesting example, you require J.C. Penney in Texas to enter their mail not in Dallas, but in Chicago, or R.R. Donnelley to enter not in Chicago but in Dallas. Those are huge increases, and just changing where you have to enter the mail can in fact be a hidden increase toward mailers. So we have to be aware of that as you look at realignment as well, although the Postal Service is required and must work to realign the network, especially with diminishing first class mail volumes.

The Reform Act also talked about service standards, and that is one of the things that you wanted to hear about today. We hope that we are very cooperative with all the players in setting up these service standards, including the Regulatory Commission. I think we must start where we are, where the guidelines are, where the standards are now. That is a good starting place on where the negotiations should begin. But it is important to note that smaller mailers that mail nationwide that are the bulk of DMA membership, and especially the non-profit mailers, receive very, very poor service for mail that is going across the country. Standard mail can be 2, 3 weeks for delivery. In this day and age of our transportation networks, the Postal Service can and must do better.

But again, in setting the goals, setting the standards which have to be met, that is only half the way. We have to have performance. The Postal Service must meet those standards. That is important, because as you have heard, mailers rely upon when the mail will go into the home. And the Postal Service's goal should be not to meet them 95 percent of the time, they should meet them 100 percent of the time. That is success, not 95 percent.

These measurement standards should be open for all to see. It is important to understand that they meet them.

Operators are hired, fulfillment people are hired, e-mail messages, Web page advertisements, in-store advertisements are all geared to when the mail is going to reach the potential customer. And it is important that they meet them. We know it and the Postal Service meets its.

And standard mail is unique, direct mailers are unique. Because you have to meet it, not beat it. The same problems occur if the mail gets to the home before expected. The ads aren't there, the operators aren't there, the inventory may not be there. So in our view, you have to meet it, not beat it, not miss it, meet it.

We think it is important that the measurement standards, you can't have a measurement for each piece of mail. But it has to be regionalized, it has to be disaggregated enough so it is not just the entire Postal Service. We have to be able to measure and see where the problems are. Marketers have to know where the issues are, where do they have to change their entry. Maybe you get better service in one region than another, and you have to change your pattern, your mailing pattern, in order to have the in-home date the same.

I thank you for this opportunity and am willing to answer any questions you may have.

[The prepared statement of Mr. Cerasale follows:]

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BEFORE THE

COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM
SUBCOMMITTEE ON FEDERAL WORKFORCE, POSTAL SERVICE, AND THE DISTRICT OF
COLUMBIA
UNITED STATES HOUSE OF REPRESENTATIVES

HEARING ON

UNITED STATES POSTAL SERVICE INFRASTRUCTURE AND REALIGNMENT

JULY 26, 2007

TESTIMONY OF

JERRY CERASALE
SENIOR VICE PRESIDENT, GOVERNMENT AFFAIRS

DIRECT MARKETING ASSOCIATION, INC.

Jerry Cerasale
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Good afternoon Mr. Chairman and members of the Subcommittee. I am Jerry Cerasale, Senior Vice President for Government Affairs of the Direct Marketing Association, and I thank you for the opportunity to appear before you as you examine the Infrastructure and Realignment of the Postal Service.

The Direct Marketing Association, Inc. (“DMA,” www.the-dma.org) is the leading global trade association of businesses and nonprofit organizations using and supporting multichannel direct marketing tools and techniques. DMA advocates industry standards for responsible marketing, promotes relevance as the key to reaching consumers with desirable offers, and provides cutting-edge research, education, and networking opportunities to improve results throughout the end-to-end direct marketing process. Founded in 1917, DMA today represents more than 3,600 companies from dozens of vertical industries in the U.S. and 50 other nations, including a majority of the Fortune 100 companies, as well as nonprofit organizations. Included are catalogers, financial services, book and magazine publishers, retail stores, industrial manufacturers, Internet-based businesses, and a host of other segments, as well as the service industries that support them.

DMA and our members appreciate this Committee’s and Subcommittee’s continued outreach to the business community on important issues involving the Postal Service. The DMA fully supported the Postal Accountability and Enhancement Act (“PAEA”). One of the major goals of PAEA was to enable the Postal Service to meet the 21st century market needs of individual and business mailers. To do that, the Postal Service must create the most efficient mail transportation and delivery network possible. The PAEA provides postal management with the tools it needs to create that network, but the tools alone do not guarantee success – it falls back to the Postal Service to provide the blueprint and carry through on the implementation.

DMA believes that postal management has great latitude in realigning its network. And we recognize that there will be significant costs involved. But I emphasize that the Postal Service cannot be allowed to implement realignment improvements that become, in effect a “hidden” rate increase that bypass the CPI cap requirements for market-dominant classes of mail.

Simply put, the Service cannot use realignment as an excuse to shed costs from its operations and transfer them to its mailing customers. For example, many postal processing facilities currently work around the clock. But if the Postal Service decides to change the allowed entry time for large drop shipments of mail at a sorting facility, for example, from 6pm to 6am, the costs for the Postal Service would decrease, because they would shift receiving volumes to less busy hours, but the costs for mailers, whose mail is time sensitive, such as weekly magazines or daily newspapers, would increase substantially.

Or as another example, if the Postal Service decided to dramatically shift the location of entry points for large mailings this would increase the mailer’s transportation costs without any increase in service provided. Such indirect cost increases for mailers amount to a hidden rate increase that should not be allowed under the rate cap regime established by PAEA. If such changes are made, at a minimum the CPI cap should be lowered accordingly.

Another goal of the PAEA was to create predictability for mail customers in not just the postage rates they are charged, but in the services they get for their postage investment. PAEA creates a framework for the Postal Service to establish much needed service standards for all mail. Service standards are very important to mailers—after all, the delivery of mail in a timely manner is what mailers are purchasing from the Postal Service. Service standards tell mailers what they are receiving for their money and help them to plan their mailing campaigns accordingly. This, it is extremely important that the mailing community knows what those standards are – and whether or not they are being met.

Under the new law, the establishment of service standards must be done in consultation with the Postal Regulatory Commission (“PRC”). At this point in time, DMA is concerned with the Postal Service response to this requirement. The PRC recently received comments on

performance measurements for market-dominant products per section 3691 of the PAEA.¹ Sadly, the Postal Service did not file comments. DMA hopes that the Service will file comments in the reply round even though mailers would then be denied the opportunity to comment on the Service's ideas.

DMA believes that the current service standards, such as they are, should be the basis for discussion on service standards. DMA also supports the efforts of the Mailers Technical Advisory Committee that is working on recommendations for service standards.

Certainly, as the postal service sets its baseline standards, we see many areas that are in need of significant improvement. There are many DMA members who send small mailings nationwide and who receive very poor service for their Standard Mail investment in those mailings. It may take weeks for mail to reach its destination across the country, and for nonprofit mailers the situation appears to be even worse. With the transportation networks in this country available to the Postal Service, it can do and must do better for the smaller Standard mailer.

However, just as with the issue of realignment, the Postal Service could use the justification of improving service standards to reduce what mailers are receiving for their money. It is our strong belief at DMA that cutting costs by cutting service violates the basis of postal reform. Therefore, any service standard setting process must prevent that cost shift. The Postal Service must become more efficient not less responsive.

On a related point, setting service standards and reporting them to the world is just half of the process. Standards that are set must be met, so the performance of the Postal Service is a key to any effective service standard program. This is very important because mailers, especially direct marketers, plan their entire business operation around the expected delivery of the mail. Telephone operators are scheduled, product is inventoried, and fulfillment personnel are hired to meet the demands of consumers who received the mail. If the mail is not delivered on time,

¹ The DMA's Comments to the Postal Regulatory Commission on Services Standards are attached and incorporated into this testimony.

phone order lines are quiet and operators are idle; warehouses are overcrowded with unordered merchandise, and fulfillment personnel have no orders to fulfill. The entire operation depends upon mail delivery.

And in a unique twist, if the Postal Service performs much better than expected, the same type problems arise: there are not enough operators to answer customers' calls; inventory is not available and orders cannot be quickly fulfilled. Thus, performance for direct marketers means MEET the delivery standard—do not miss it or beat it, just meet it!

Standards cannot be set simply at the class of mail level. Mail is prepared by presort level, by entry post office, by automation level and by shape. A robust service standard system must take all of these variables into account when measuring mail delivery times. We understand that there cannot be standards for each piece of mail, but there must be sufficient disaggregation for mailers to rely upon them for their mail.

In conclusion, the American economy needs an efficient Postal Service to support the \$900 billion economic engine that the US Mail generates. But efforts toward efficiency should not be efforts to shift costs to Postal Service customers as a disguised rate increase. The American public – from the person mailing a birthday card to the largest business mailer -- deserves to know what they are getting for their postage costs, and feel confident that they will receiving the level of service that they have come to expect.

Reductions in service that shift costs to mailers are, in effect, hidden rate cases. The CPI cap established by the postal reform law cannot be bypassed by realignment and service changes. And finally, it is imperative to remember that mailers need the Postal Service to meet its service standards, since both missing them and beating them cause havoc to broader sales and fulfillment operations.

The DMA thanks the Subcommittee for allowing it to present our views at this hearing. I will be happy to answer any questions you may have for me.

Postal Regulatory Commission
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BEFORE THE
POSTAL REGULATORY COMMISSION
WASHINGTON, D.C. 20268-0001

_____)	
Service Standards and)	
Performance Measurement)	Docket No. PI2007-1
for Market Dominant Products)	
_____)	

DIRECT MARKETING ASSOCIATION, INC.
INITIAL COMMENTS
PURSUANT TO PRC ORDER NO. 21
(July 16, 2007)

The Direct Marketing Association, Inc. ("DMA") respectfully submits these Initial Comments in response to Order No. 21 issued by the Commission on June 13, 2007,¹ on the subject of performance measurements for market-dominant products under section 3691 of the Postal Accountability and Enhancement Act ("PAEA").²

I. Importance of a Workable System for Measuring Service Standards

As an initial matter, DMA would like to emphasize the importance of the subject that the Commission is addressing in this docket. As DMA has stated in the past,³ the fundamental compromise reflected in the PAEA is based on the proposition that mailers will not face rate increases greater than the rate of inflation, as measured by the CPI. A degradation of service standards is nothing more than a rate increase in disguise, and the Commission should assure that this type of rate increase does not occur. Establishing a workable, reliable system for measuring the service being rendered to mailers by the Postal Service is a prerequisite to assuring mailers that they are not subjected to this type of rate increase.

¹ PRC Order No. 21, Notice of Request for Comments on Modern Service Standards and Performance Measurement for Market Dominant Products, (June 13, 2007).

² Public Law 109-435.

³ E.g., DMA Initial Comments in PRC Docket No. RM2007-1 (April 6, 2007) at 4.

II. Service Levels

DMA believes that the current service levels should form the basis of the standards that the Commission will develop under section 3691 of the PAEA. However, DMA will defer to industry recommendations from MTAC Workgroup 114 on this subject.

III. Level of Disaggregation

DMA assumes that modern service standards must be promulgated by class and by subclass. However, finer levels of disaggregation will enhance the value of service standards to both senders and recipients and help assure reliability and speed of delivery. Thus, the Commission should give serious consideration to establishing distinct standards for mail with different characteristics, especially if those characteristics have a significant impact on the way in which the Postal Service handles the mail. For example, within the same class or subclass, differences in entry points, differences in levels of presortation, differences in levels of automation compatibility, differences in ZIP-code pairs, and differences in shape can have a substantial impact on the steps that the USPS needs to take to process the mail, and, therefore, can have a substantial impact on the service standards that mailers should expect the Postal Service to be able to meet.

DMA fully appreciates that there comes a point where the level of disaggregation may become so fine that it becomes impractical, either from an operational point of view or from a financial point of view, to create distinct service standards and to measure USPS compliance with them. DMA simply wishes to encourage the Commission to recognize the fact that, from the point of view of each mailer, aggregate service standards are virtually meaningless. What matters to each mailer is that service that its mail receives, and that mail has very specific characteristics in terms of automation compatibility, presort levels, etc.. Each mailer needs to know what level of service it can expect, and to what extent the Postal Service is meeting that standard. Subclass-wide data has little relevance to the individual mailer.

IV. Method of Measurement

Once standards are established, of course, there needs to be a way to measure the extent to which the Postal Service is meeting them. This measurement system must be transparent. The information needs to be public and it needs to be provided on a periodic basis-- no less frequently than quarterly in DMA's view.

Also important is the level of disaggregation in which this information is provided. Nationwide numbers are not useful. They are not useful to specific mailers, and they are not useful to the Commission or the Postal Service in trying to identify sources of problems in meeting service standards. To be useful, the level of disaggregation should not be broader than each Postal Service Area.

V. Enforcement of Service Standards

Finally, DMA firmly believes that performance is much more important than penalizing non-performance. Thus, DMA urges the Commission to monitor service performance carefully and to assure that the Postal Service develops and executes plans for remedial action when systemic failures or service degradation is identified. In this connection, the Commission should consider that mailers are purchasing service based upon published service standards, and sub-standard performance by the Postal Service means that the mailers did not get what they paid for. As a last resort, and DMA emphasizes that this would be a measure of last resort, the Commission should treat persistent non-compliance as a price increase and, therefore, to reduce permissible rate increases under the CPI cap (as Postcomm, the UK postal regulator, does in England).

Respectfully submitted,

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July 16, 2007

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Mr. DAVIS OF ILLINOIS. Thank you very much.
We will go to Mr. May.

STATEMENT OF TIMOTHY J. MAY

Mr. MAY. Thank you, Mr. Chairman. My name is Timothy May, I am a partner in the law firm, Patton Boggs, and am general counsel of the Parcel Shippers Association, on whose behalf I appear today.

Parcel Shippers is an industry association whose membership packages, largely from businesses and consumers, and companies that support those activities. Our main objective is to encourage a competitive environment that results in the best possible service at the lowest possible cost. Our members use all the private carriers as well as the Postal Service.

Our members have a hand in the vast majority of the Postal Service's products and the package services class, which is now categorized as competitive products under the new law. They also ship and consolidate for delivery to the Postal Service hundreds of millions of packages such as first class mail parcels, standard mail parcels, bound printed matter and media mail. Those are now categorized as market-dominant products. It is for those products that the Postal Service must in the future develop measurement standards and reporting systems.

At the moment, for most other mail, the market-dominant mail, Postal Service really only has guidelines, if you can call them that, rather than standards. And it doesn't really measure mail that consists of the most substantial volumes it delivers. For example, for most packages, the delivery is anywhere from 2 to 9 days, depending upon where you put it in and where it is going. In the case of standard parcels, those less than a pound, the standard delivery is in 3 to 10 days, depending upon how far it goes.

But again, those really aren't standards. It is kind of a guideline and we hope it gets there. There is very little measurement of that.

What our members want is a consistency of speed and reliability. We are particularly concerned about products that are delayed beyond the expected time of delivery, which we all refer to as the tail of the mail. Those are the several percentages of mail that just don't get there on time. The customers are irate, all kinds of business is lost, there are a lot of costs involved in reshipping to them.

But as far back as 2000, parcel shippers asked the Postal Service for delivery standards, performance measurements and reporting for a new category of package services called Parcel Select Service that was approved in 1999 by the Postal Rate Commission. That began a collaboration between our association and the Postal Service's Mailers Technical Advisory Committee, to resolve issues such as how to start and stop the service clock, and critical entry times.

Those issues are now resolved today. We have excellent Parcel Select delivery standards, 1 day for parcels entered at the destination delivery unit, 2 days for parcels entered at the destination sectional center facility and 2 to 3 days for parcels entered at the destination bulk mail facility. That is excellent service, and we are getting very high performance, upwards of 98 percent on time.

Last year, the Government Accountability Office, and you had testimony today, issued a generally critical report on Postal Service

delivery performance standards, but said that a noteworthy exception was the standards that evolved through the collaborative efforts of parcel shippers and the Postal Service for parcel select parcels. While these standards and reporting techniques were developed for what are now deemed to be the competitive products, we see no reason why that same or similar standards are not reasonable as well for market-dominant packages.

The Postal Service now measures and reports for us using delivery confirmation data that allows the service to be accurately measured and reported at a very detailed level. Parcel Select shippers can get detailed summary reports regarding the performance delivery on their own parcels and can compare that with reports of aggregated data to see how they are doing compared to their peers. Much-improved technology is now available such as intelligent mail bar code, and that provides transparency, such as tracking and tracing.

Unique identification of mail pieces should be the norm in the future, not the exception. Also in the future, any good performance measurement system, to be effective, will have to disaggregate data on the tail of the mail, that mail that is there too late, how much is it, where is it, so those packages are delivered later than the standard.

The law now requires that 6 months after the development of the standards and measurement system, after that, the Postal Service has to file a plan to meet these standards. Also, a central part of that plan deals with postal facilities. Congress found, as you know, that there were more facilities than the Postal Service needs, and that streamlining of the distribution network could pave the way for potential consolidation of sorting facilities and the elimination of excess costs. The Postal Service must detail its plan for this rationalization of the infrastructure.

The Postal Service was already at work on that prior to the enactment of the recent reform law, and even adopted a proceeding at the Postal Rate Commission called the Evolutionary Network Development changes [END]. You had some testimony just prior to this from the director at the Postal Rate Commission about that proceeding and the deficiency they found in the Postal Service's approach. Interestingly enough, Congressman, one of our large members, we developed this information to give to the Postal Rate Commission, one of our large members in Dallas, that ships out of the bulk mail center in Dallas, one of the proposals, but again this was all very sketchy, one of the proposals of the Postal Service was to do away with the bulk mail facilities and substitute in their place up to perhaps 100 regional distribution centers.

In Texas, if that were to happen, there would likely be five distribution centers in Texas instead of the one bulk mail center. They are not going to move it to Chicago, but they did have plans to move it out of the BMC and to move it into these new regional distribution centers.

Our member calculated the additional costs to them of having to bring their parcels to five distribution centers around the State rather than the one BMC in Dallas, and also to have to do away with bed-loading, because they were going to require containerization, and the amount of the cost to that mailer for

those packages being shipped out of Texas, they estimated it to be an increase of anywhere from 16 to 26 percent in their total costs.

Now, the Postal Service had given no consideration to that whatsoever, the impact of that on mailers, the cost to mailers. So that is simply unacceptable, and that has to be considered.

We have been working with the Service, again through the MTAC process, on END. Our committee has formally presented a position paper to MTAC on this restructuring. That is attached to my testimony as Exhibit 1. That paper explains the principles we believe should guide the Postal Service as it realigns its network.

Consistent deliveries, lower end to end cost in service, enhancing work-sharing discounts, visibility, effective containerization, not just—not eliminating bed-loading, unless that is necessary, and maximum automation. The Service needs to heed advice from committees such as ours and we believe that the success that we had and that can solve the process on standards can be a model for the facilities streamlining that has to take place.

Obviously that process requires consultation not only with mailers, but with the communities affected and employees of the Postal Service who will undoubtedly be affected. We hope that the subcommittee will continue to scrutinize carefully the progress the Service makes in rationalizing its infrastructure and in formulating and implementing new standards and measurements of service and reporting systems comparable to what we now have for Parcel Select.

Thank you for this opportunity.

[The prepared statement of Mr. May follows:]

TESTIMONY OF TIMOTHY J. MAY,
GENERAL COUNSEL PARCEL SHIPPERS ASSOCIATION
BEFORE THE
SUBCOMMITTEE ON FEDERAL WORKFORCE, POSTAL SERVICE,
AND THE DISTRICT OF COLUMBIA,
THURSDAY, JULY 26, 2007

Mr. Chairman,

The Parcel Shippers Association is pleased to present to the Subcommittee its views on the infrastructure and realignment of the US Postal Service, the changes needed in its delivery standards to reflect changes in mail preparation and delivery, and the Service's plan to close annexes and consolidate operations.

PSA is a voluntary industry association consisting of members that ship packages, largely from business to consumers, and companies that support those activities. A list of members is available on its web site at www.parcelshippers.org. PSA's mission is to promote competition in the package delivery sector. It strives to encourage a competitive environment that results in the best possible service at the lowest possible costs.

PSA's members, collectively, touch the vast majority of the Postal Service's product in the Package Services class now categorized as "competitive products." *See* 39 U.S.C. §3631(a) (PAEA). Its members also ship, or consolidate for delivery to the Postal Service, hundreds of millions of packages, such as First-Class Mail parcels,

Standard Mail parcels, Bound Printed Matter, and Media Mail, that are now categorized as “market dominant products.” See U.S.C. §3621(a). PSA members also make extensive use of carriers other than the Postal Service.

PSA is desirous that service standards and performance measurement systems not be complicated: we want consistent, reliable and affordable package delivery by the Postal Service and its partners. Obviously, consistency and speed are important to us, as they are to all mailers, but we are particularly concerned about consistency because delivery of products delayed beyond the expected time, the so-called “tail of the mail”; is a serious business problem for our members, that can result in increased costs for shipping replacement goods and loss of customers because of their dissatisfaction.

As far back as 2000, PSA asked the Postal Service for delivery standards, performance measurement, and reporting for parcels. Thus began a collaboration between our association and the USPS Mailers Technical Advisory Committee (MTAC) to resolve the difficult issues such as how to start and stop the service “clock” and critical entry times. Both are resolved and today there are excellent standards for Parcel Select delivery; for instance, 1 day for parcels entered at the Destination Delivery Unit (DDU); 2 days for parcels entered at the Destination Sectional Center Facility (DSCF); and 2-3 days for parcels entered at the Destination Bulk Mail Center (DBMC).

In a GAO report generally critical of USPS delivery performance standards and reporting, the GAO said that a noteworthy exception were these standards that evolved through the collaborative efforts of PSA and the Postal Service for Parcel Select parcels. (Delivery Performance Standards, Measurement, and Reporting Need Improvement. GAO-06-733 (Washington DC, 2006) (Page 15, see pages 16 & 35)

A noteworthy exception involves useful delivery standards that USPS created for a specific type of Package Services mail called Parcel Select, when it was introduced in 1999. These standards were updated in 2002. USPS's standards for Parcel Select differentiate speed of delivery by point of entry, e.g., 1 day for entry at the destination delivery facility or 2 days for entry at the mail processing center that forwards the parcels to the delivery facility. These standards were intended to provide an appropriate benchmark for delivery performance measurement in order to facilitate efforts to improve the delivery performance for this mail. USPS subsequently collaborated with officials of the Parcel Shippers Association (PSA) to implement delivery performance measurement for Parcel Select against these standards, and the results are factored into individual pay-for-performance incentives for many USPS managers.

All these standards were developed for what are now deemed to be competitive products; we believe that the same or similar standards are reasonable as well for the market-dominant parcels.

Today, Parcel Select service is measured and reported using delivery confirmation data. This measurement has resulted in a significant amount of delivery data that has allowed service to be accurately measured and reported at a very detailed level. The Postal Service has a website (mailtracking.usps.com) which currently

provides Parcel Select shippers with detailed and summary reports regarding the Postal Service's performance delivery for that parcel shipper's own packages. And shippers, through reports with aggregated data, can compare their own experiences with a broad spectrum of other results. This has proved most beneficial to our members in planning their mailings and working with the Postal Service to resolve service issues. We see no reason why the Postal Service should not provide similar reporting for shippers of all types of market-dominant parcels.

Under the PAEA, delivery standards and performance measurement systems must now be created for all market-dominant mail. While our own experience with parcels represents only a small part of the population of mail, we see no reason why the successful experience we had with the Postal Service in developing service and performance measurements cannot be successfully syndicated to all types of market-dominant mail. Much improved technology is now available, such as the Intelligent Mail Barcode, which provide "transparency", such as tracking and tracing. Unique identification of mailpieces should be the norm, not the exception.

To return to a point we made about the particular problem of the "tail of the mail", we have found that this phenomenon is the primary cause of unnecessary cost and customer dissatisfaction, and that we believe any performance measurement system to be effective must disaggregate data on the "tail of the mail".

Section 302 of the PAEA requires the Postal Service to submit a "plan" six months after the December 22, 2007 due date for the development of service

standards. This plan has to explain how the Postal Service will meet the standards it develops. A central part of that plan deals with “postal facilities” and in §302(c) of the PAEA, Congress found “the Postal Service has more facilities than it needs and the streamlining of this distribution network can pave the way for potential consolidation of sorting facilities and the elimination of excess costs.”

The Postal Service was at work on this subject prior to the enactment of the PAEA and even docketed a proceeding at the Postal Rate Commission (Docket No. N2006-1, Evolutionary Network Development Changes) or otherwise known as END. PSA participated in that Docket.

In addition, PSA has worked with the Postal Service and industry through the MTAC process on END. PSA’s committee on END developed “input” for the MTAC workgroup, outlining PSA’s position on the whole issue of infrastructure change and realignment. That committee position is attached as Appendix I.

Specifically, our committee found:

The Facilities Plan must provide a “process for engaging policy makers and the public in related decisions.” Similarly, the PRC’s Opinion in Docket No. N2006-1 advised the Postal Service to solicit input from major mailers as it redesigns its network. PSA and its END Committee agree that the USPS END process and the eventual “Facilities Plan” can benefit substantially from suggestions as to what its customers find most important and how customers can benefit most from USPS services. This will result in better overall service.

The PSA END Committee has evaluated the needs and concerns of PSA members whose parcels represent the vast majority of

Parcel Select and a substantial volume in other mail subclasses, particularly the Standard Mail Regular subclass. This paper briefly explains the principles that the Committee believes should guide the Postal Service as it realigns its network. These principles are organized as follows: (1) consistent delivery, (2) end-to-end cost and service, (3) worksharing discounts, (4) visibility, (5) containerization, and (6) automation.

One of the particular concerns that PSA had with the Postal Service's END activities was their failure to recognize that rate changes should accompany radical changes in their network development initiatives. For example, previously, it was planned that the work currently being performed at the Postal Service's 21 Bulk Mail Centers (BMCs) and 7 Auxiliary Service Facilities (ASFs) would in the future be carried out at roughly 28-100 Regional Distribution Centers (RDCs). While not necessarily disagreeing that operationally these changes made sense, PSA was concerned that the END initiative would be likely to increase mail preparation and entry costs for parcel shippers, particularly those that enter their parcels at DBMCs. In addition to having to transport parcels to a larger number of facilities to qualify for the DBMC rate, it was expected that parcels entered at RDCs would have to be prepared on pallets or on pallet boxes, rather than the current practice of bedloading such pieces.

One of our large members did a study to estimate the cost of such changes to them. They found that the additional cost of entering mail at a much larger network of facilities to qualify for DBMC rates and to meet expected containerization

requirements was likely to be significant and to far exceed the postage savings that would result from qualifying for lower parcel postage rates. That member performed a focused study of the cost of parcels being shipped in Texas. Their analysis found that the required changes in preparation would result in a net cost increase of 59 cents to 98 cents per parcel. That is a huge increase (16% - 26%), considering that the postage currently paid on such parcels averaged approximately \$3.75. In its own work, the Postal Service had not adjusted either its revenue requirement or its DBMC cost estimates to reflect the shift in cost from the Postal Service to shippers. The cost savings achieved by the Postal Service through Network Realignment should be reflected in the rates charged to mailers.

Conclusion

We welcome the Subcommittee's interest in this subject matter; both the Postal Service and the Postal Regulatory Commission have a role given to them by the Congress. Congress has found there is an inadequacy in the delivery standards and reporting thereon and has found an excess of obsolescent postal facilities which are harming the Postal Service's efficiency. We hope that this subcommittee will continue to keep a close eye on both the Postal Service and the Postal Regulatory Commission as they evolve their development of new standards, reporting measures, and infrastructure changes.

We are proud of the pioneering work that our association did with the Mailers Technical Advisory Committee to establish Parcel Select delivery standards and service measurements and reports on those standards. It can be a model for the development of standards and measurement procedures for market-dominant products. We urge the Postal Service to take heed of the advice given by our END committee in proceeding with its work on Network Realignment. We believe that the success PSA has had in the consultative process on standards can be a model for the facility streamlining required by the PAEA (Section 302). We thank the Subcommittee for this opportunity to express our views and for its continuing interest in this vital service to the American people.

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PSA Position on USPS Network Realignment

For almost two years, the Parcel Shippers Association (PSA) has been working with the United States Postal Service (USPS), through the Mailers Technical Advisory Committee (MTAC), to address industry concerns with respect to the USPS Evolutionary Network Development (END) initiative. This follows, and to some extent coincided with, PSA's participation in the USPS Network Integration and Alignment (NIA) effort, and participation before the Postal Regulatory Commission (PRC) in connection with Docket No. N2006-1, Evolutionary Network Development Service Changes, 2006.

In early 2006, PSA formed an END Committee, currently consisting of 12 members from throughout the parcel shipping industry, to provide input to MTAC and the Postal Service on this important issue. The efforts of that Committee led to the establishment of two END-related MTAC Workgroups – WG #107 “FAST/Surface Visibility for Parcels” and WG #109 “Optimizing Parcel Prep & Entry for Seamless Acceptance.” Numerous PSA members have been active on those workgroups.

The END process was encouraged and necessarily accelerated in December 2006 with the enactment of the Postal Accountability and Enhancement Act (Public Law 109-435). Among other things, that law requires the USPS to develop a “Facilities Plan” that must include “a strategy for how the Postal Service intends to rationalize the postal facilities network and remove excess processing capacity and space from the network.”

The Facilities Plan must provide a “process for engaging policy makers and the public in related decisions.” Similarly, the PRC's Opinion in Docket No. N2006-1 advised the Postal Service to solicit input from major mailers as it redesigns its network. PSA and its END Committee agree that the USPS END process and the eventual “Facilities Plan” can benefit substantially from suggestions as to what its customers find most important and how customers can benefit most from USPS services. This will result in better overall service.

The PSA END Committee has evaluated the needs and concerns of PSA members whose parcels represent the vast majority of Parcel Select and substantial volumes in other mail subclasses, particularly the Standard Mail Regular subclass. This paper briefly explains the principles that the Committee believes should guide the Postal Service as it realigns its network. These principles are organized as follows: (1) consistent delivery, (2) end-to-end cost and service, (3) worksharing discounts, (4) visibility, (5) containerization, and (6) automation.

Consistent Delivery

PSA members place a higher value on the Postal Service improving the predictability and consistency of delivery, than on reducing end-to-end delivery times, which in turn would result in a higher-cost network. Thus, the USPS should focus on eliminating the delivery tails – which for Parcel Select currently range from 4 to 7 days and sometimes more – experienced by shippers entering parcels at destination bulk mail centers (DBMCs), rather than on increasing the speed of delivery. Investments in facilities, automation, transportation and human resources should focus on improving compliance with the current Parcel Select 1- 2 day delivery standard and the MTAC Work Group #114 Service Standard recommendations for Standard, BPM, Media and Library mail parcels. Achievement of 98% on-time service performance (regardless of package size or ZIP Code) should be the goal. Further, given the importance of consistent, predictable delivery, the initial focus of the END initiative should be on improving service at poor performing facilities where the opportunities for improvement are substantial.

End-to-End Cost and Service

Parcel delivery by the Postal Service is best viewed as a partnership between parcel shippers, consolidators, and the Postal Service. In most instances, parcel shippers and consolidators sort and transport parcels to destination postal facilities where the Postal Service sorts and prepares them for final delivery. Given the extent of this partnership, the Postal Service's competitiveness in the parcel delivery marketplace is determined based upon *end-to-end* costs and transit times (including both Postal Service and private sector cost and transit times), not just USPS costs and service levels. A further consequence of this partnership is that changes to the postal network not only affect USPS costs and delivery times, but also private sector costs to prepare and enter parcels at USPS facilities and the associated transit times.

Given this, when evaluating the impact of END, USPS must take into account not just its internal impact, but also how it affects private sector costs and transit times. Focusing only on the USPS side of the equation would almost certainly lead to a less-than-optimal network. For example, holding service levels constant, adjusting the postal network in a manner that reduces USPS costs by \$1 billion, but increases private sector mail preparation and transportation costs by \$2 billion would be terribly inefficient.

Of particular relevance to the END initiative, requiring parcel shippers to enter parcels at a greater number of destination facilities to qualify for the END equivalent of DBMC rates will increase private sector costs (e.g., transportation costs, containerization costs, handling for additional sorts, expanded dock areas) and transit times (e.g., by requiring shippers to "hold" parcels longer to generate sufficient volume to fill a container for a particular destination facility). Thus, a network that requires parcel shippers to enter parcels at a larger number of destination facilities would have to substantially reduce USPS costs and improve USPS delivery times just to maintain existing end-to-end cost and service levels.

Worksharing Discounts

To garner industry support for realignment and encourage efficient parcel preparation and entry practices, the Postal Service should adjust the size of worksharing discounts that it offers *in unison* with changes to the postal network. Specifically, PSA understands that a likely realignment scenario is for the Postal Service to add “DBMC” entry points to the postal network. As discussed above, such a change would increase private sector transportation costs. Unless worksharing discounts are increased to reflect the USPS cost savings resulting from the additional private sector work, such realignment would increase the distribution costs faced by parcel shippers: postage rates would remain unchanged while private sector transportation costs would increase. Thus, shippers would not benefit even if the realignment increased overall efficiency. See PSA-T-1 in Docket No. R2006-1.

Second, adjusting discounts as the network is realigned to ensure that the discounts continue to be *cost-based* will encourage efficient preparation. As explained by Dr. John Panzar in Docket No. R2006-1, setting discounts equal to costs avoided “leads mailers to choose to perform worksharing if and only if doing so lowers total postal sector costs. The reason is quite intuitive. If the mailer’s cost is less than the discount offered, it is profitable for the mailer to do the work – and total postal sector costs decrease. If the discount is not sufficiently attractive, the Postal Service continues to provide the service component.”

Visibility

For USPS to be competitive in the package delivery market, it must provide both shippers and their customers with the ability to track their packages as they flow through the postal system. As USPS realigns, it must ensure that its equipment is sufficient for this task. In particular, the Postal Service must be able to provide shippers with “scan” data showing where containers and parcels are in the network. Further, to allow parcel shippers to effectively monitor USPS service and effectively plan their mailings, the Postal Service should provide all parcel shippers with service performance data similar to the existing Parcel Select Performance Reports.

Containerization

Containerization requirements have a significant effect on parcel shipping costs. Not only do they affect the direct costs to purchase and handle containers, they also influence shippers’ ability to efficiently utilize trailers, which is a critical driver of private sector transportation costs. For example, eliminating the option of bed loading parcels will likely reduce cubic utilization of trailers by approximately forty percent. Thus, the Postal Service should redesign its network with an eye towards retaining the maximum possible flexibility for containerizing parcels.

In particular, the Postal Service should retain bed loading as a containerization option wherever possible. Further, with the possible introduction of additional entry points, the Postal

Service should consider allowing shippers to use an “intermediate” container – such as the EO, EH, and E containers used by the Air Freight industry – that can hold more parcels than a sack, but less than a pallet. EO, EH, and E containers – which vary from approximately ¼ to ½ of the size of a pallet box – offer easy loading, stacking, cubic utilization, off-loads and facility movement for both USPS and parcel shippers.

Further, the Postal Service (in collaboration with the parcel shipping industry) should develop preparation and entry rules and procedures to ensure the efficient use of containers and trailers, including:

- Reviewing and, where appropriate, modifying rules related to the maximum height of and stacking limits for pallets;
- Establishing procedures to allow parcel shippers to reuse their containers, rather than using them just once;
- Revising preparation rules – e.g., allowing presort minimums to be met based upon combined parcel volume across all subclasses in a mailing, rather than on a subclass-by-subclass basis – to encourage the commingling of multiple subclasses of parcels in the same containers;
- Allowing all parcels – regardless of subclass and machinability – to be entered at the same facilities to qualify for destination entry discounts.

Automation

Increasing the use of automated equipment to process parcels is critical to controlling parcel processing costs and providing shippers with visibility to their parcels as they flow through the postal system. PSA thus applauds the Postal Service for broadening the machinability criteria to encompass lighter weight parcels. As the Postal Service realigns its network, it should attempt to maximize the automated processing of parcels. PSA specifically encourages the Postal Service to --

- Evaluate whether the machinability criteria can be broadened further to include a greater scope of parcel dimensions as well as a greater scope of packaging (e.g. paperboard envelopes and bags which can be run on Automated Package Processing Systems (APPS)).
- Broaden the array of equipment that can read parcel barcodes in an automated fashion, reducing the need for manual intervention to orient and key the zip codes on the packages.
- Work with mailers to develop a smaller Delivery Confirmation barcode that can be accommodated on smaller parcels – e.g., Standard Mail parcels – with limited real estate.

To enhance visibility, the Postal Service should also expand the collection of scan data on parcel processing equipment and continue to share such data with the industry.

Conclusion

PSA looks forward to continuing to work with the Postal Service and encourages it to communicate contemplated network changes at early stages in their consideration to achieve END results which benefit all. Adhering to the principles discussed above will make such a result much more likely.

Mr. DAVIS OF ILLINOIS. Thank you very much.

Mr. Marchant, do you have any questions?

Mr. MARCHANT. Yes. Last week the subcommittee looked at the issues concerning outsourcing on the part of the Postal Service. Do you or your members or your clients have any views on the whole concept of outsourcing and independent contractors?

Mr. MAY. We are not, per se, opposed to outsourcing. But to us, we think you have to make the case for it. You have to demonstrate that it really cannot be done effectively in-house and that indeed, you will save money by going out of the Service. And also, there are important considerations you have with your employee agreements. The contract the PMG just signed with the Letter Carriers Union, for example, does not allow them to surplus any existing Postal Service carrier routes by outsourcing them.

So they don't have a free hand in this. But as in private industry, labor and management collectively bargain and they agree. The Postal Service is somewhat handicapped, because under the present system, in an impasse, they have to go to impasse arbitration. That has often been not satisfactory. Happily this time, for example, with the Letter Carriers contract just consummated, they were able to reach an agreement without having to go to arbitration.

But certainly there will be occasions when there will be outsourcing. But we don't have a position per se on it. We are not urging that it be done. If it makes sense, do it. But make the case that it does.

Mr. MARCHANT. Mr. Cerasale, do you see the effective future of the Postal Service's being effective using some kind of outside contractors, do you see that as an essential part of an effective delivery system for your clients and customers?

Mr. CERASALE. The Postal Service has historically used contractors for transportation and so forth in the past. I agree with Mr. May that they have to make a case for it.

One of the things for an efficient Postal Service and how it works, however, is that the labor management climate within the Postal Service, the Postal Service has to work and work well, and that means management and their employees working together and working well. That is part of an efficient Postal Service as well. We are not opposed to contracting out. But we are not saying that you have to contract out. We think that right at the moment, it is part of the collective bargaining agreements, I think, with all the unions. The Postal Service has to work within that framework that it currently has.

I don't think you take it off the table. I don't think you say, it is not there. I think it is part of what the Postal Service has in front of it, part of the tools it has to work with and with its employees. But an efficient Postal Service, one that works efficiently for us is one that works with its employees who are, where there are customers, are they both employees and Postal Service. So it has to work together. So that is a part of what efficiency is as well.

Mr. MARCHANT. Thank you, Mr. Chairman.

Mr. DAVIS OF ILLINOIS. Thank you very much.

Gentlemen, during this part of the discussion, on two or three occasions I heard differentiation between guidelines versus stand-

ards, or I heard mention that in some instances, the Service has guidelines but not standards. What is the difference?

Mr. MAY. Well, Mr. Chairman, a standard is something you have committed to, that you will get delivery. For example, the commitment we have for Parcel Select standards is if we drop our packages at the destination delivery unit, that is the standard, which means we have been guaranteed and our customers can rely on that, that is going to be delivered in 1 day and with a 98 percent success rate. So that is a standard.

A guideline says, well, it will take anywhere from 2 to 9 days, depending on where it is in the system. That is a guideline. Frankly, to the extent that they even measure it at all, it is less than 50 percent accurate. So lots of work has to be done there. There is no reason why everybody can't have the same kind of standards and reportability and reliability that we have been able to achieve for Parcel Select by cooperating with the Postal Service.

Mr. DAVIS OF ILLINOIS. And you are wanting the Postal Service to move closer to a level of exactness?

Mr. MAY. Exactly. And we see no reason why, within some tolerance, they can't have the same quick delivery, quick certain delivery guidelines and reporting systems for all of the mail, not just Parcel Select.

Mr. CERASALE. From our view, what you measure is what you receive. So the real key for these standards is, we have to have measurement of those standards. That is where management will put efforts and make sure they meet them. So the big key in service, creating service standards, is the measurement and the guidelines that we have. There really is not measurement there.

Mr. MCLEAN. The other key to this is that performance measurement that we are discussing today will be much more detailed and will be made public. The standards that are being established are a fine idea, but without the measurement, they would essentially be meaningless. Today the Postal Service has two measurement systems involving outside auditors. One measure the general public attitude toward the Postal Service, and the other measures the very small percentage of a specific type of mail. These standards will be much broader, as will the performance measurement systems.

So we will get a much better sense of how the Postal Service is doing when it comes to delivering large chunks of the mail that really provide almost 80 percent of their revenue throughout the year, not just the revenue that comes from a very small subset of a single class of mail.

Mr. DAVIS OF ILLINOIS. As the Postal Service goes through its thinking about realignment, are you all satisfied that you have an opportunity for input into the process?

Mr. MAY. Well, we certainly have. We have no complaints about that. That doesn't mean they are going to listen to us and agree with everything we have said. But we have, largely through the Mailers Technical Advisory Committee process, we have had and are continuing to have the opportunity to present our views on standards for other package services and measurements, how they will be measured, and also our views, and we will put it in writing eventually, what our position is on the restructuring of the infra-

structure of the Postal Service. As I say, we have gone into print with that. It is attached to our testimony.

Mr. DAVIS OF ILLINOIS. Mr. Winn.

Mr. WINN. I would have to answer that question as no, we have not had sufficient communications nor been really allowed to provide good input from our perspective. I will give you the example. We have consolidation facilities all over the country where we consolidate mail and then we drop ship it certain times at certain locations in the Postal Service. The location of those facilities is critical to where we are entering mail. So if the network is realigned without visibility into what it is going to look like in the future, our consolidation facilities may be in totally the wrong places. We will have to move, increased costs to our customers, again, total system costs.

Mr. DAVIS OF ILLINOIS. Mr. McLean.

Mr. MCLEAN. I think that where the Postal Service could improve in this area is by talking to us more often and giving us more lead time when it plans on changes, whether they are closing or consolidation. Mike, in his testimony, gave a great deal of attention to the in-home delivery date, and that is what is really affected, as well as the transportation costs that mailers will be required to pay.

Mr. Galligan, the witness who testified earlier today, has been very accessible to us. We are in the process of trying to schedule a meeting with the Postmaster General and our entire membership some time between now and the end of the year. The network realignment will be one of the topics that we will talk with him about.

So we are seeing more accessibility. We just hope that we will see more information a little farther ahead than we have in the past.

Mr. DAVIS OF ILLINOIS. Mr. Cerasale.

Mr. CERASALE. The accessibility is there. I don't necessarily think that we have seen all the information that we think we should receive and that is a really important part of the discussion, is to take a look at the plans and then listen to us as we talk on them. I think we are encouraged by where the Postal Service is moving on this. But the jury is still out whether or not they really are giving us the plans and having some meaningful discussion on them.

Mr. DAVIS OF ILLINOIS. Well, it looks like our timing is perfect. Gentlemen, I want to thank you all for your testimony, for being here with us. I want to thank all of the witnesses for appearing and all of those who have come.

Of course, we have a vote on and I have to go and vote, so this hearing is adjourned.

[Whereupon, at 4 p.m., the subcommittee was adjourned.]