Postal Regulatory Commission
Submitted 3/30/2010 3:40:49 PM
Filing ID: 67421
Accepted 3/30/2010

USPS-T-2

BEFORE THE
POSTAL REGULATORY COMMISSION
WASHINGTON, D.C. 20268–0001

SIX-DAY TO FIVE-DAY CARRIER DELIVERY AND RELATED SERVICE CHANGES, 2010	Docket No. N2010-1

DIRECT TESTIMONY OF

JOSEPH CORBETT

ON BEHALF OF THE

UNITED STATES POSTAL SERVICE

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I. Biographical Sketch

I am Joseph Corbett, Executive Vice President and Chief Financial Officer (CFO) of the United States Postal Service. I am responsible for managing Postal Service finances and for reporting to and advising senior postal management and our Board of Governors on our financial condition and options. I direct the organization’s extensive Finance and Supply Management functions and serve as a member of the Executive Committee. I joined the Postal Service in this position in February of 2009.

My professional background encompasses more than 25 years of finance, treasury and accounting experience. A certified public accountant, I have extensive experience in strategy, financial planning and analysis, accounting, financial reporting, and banking and capital market transactions. At the outset of my business career, I worked for over a decade with KPMG, a major accounting firm, becoming a senior member of their Commercial Practice Group that served publicly and privately held companies in the manufacturing, professional services and transportation industries.

In the 15 years prior to joining the Postal Service, I served in senior management roles at two large commercial companies: controller, chief accounting officer, executive vice president, and CFO at Intelsat, Ltd; and Chief Accounting Officer and CFO at Bearing Point, Inc. In these positions, I led multiple efforts related to all aspects of accounting, financial planning and reporting, and treasury transactions, including an initial and numerous other

SEC-filed capital market transactions. In the past, I have also served as a director of two private companies.

I hold a Bachelor of Business Administration degree from George Washington University and am a member of the American Institute of Certified Public Accountants and of the Greater Washington Society of CPAs.

II. Purpose of Testimony

The purpose of my testimony is to provide the financial context for the Postal Service's request for an advisory opinion regarding its plan to eliminate the delivery of mail to street addresses on Saturdays and implement related service changes in FY 2011.

In doing so, I will provide the Commission with details of the Postal Service's recent financial history and of its current financial condition, and will discuss the financial realities we face for the near-term future. In my testimony, I will report on the market and financial conditions that, after long study and consultation, led us to conclude that this change to five-day delivery is necessary and unavoidable.

III. The United States Postal Service in 2010

A wholly self-sustaining enterprise, the Postal Service depends upon revenues from the sale of postage and mailing services for the revenue necessary to sustain its operations and meet its universal service obligations to the American public. For decades, as revenues from the continuous growth in mail volumes kept pace with the increasing costs of the ever-expanding postal delivery network, this business model served its public purpose. It no longer does.

The Postal Service is now in dire financial condition. Precipitous and historic declines in mail volumes and revenues, combined with the growing costs of our expanding delivery network, as well as the massive new costs imposed by postal legislation, have resulted in a grave and unsustainable financial imbalance. Despite prudent management of our business and aggressive cost cutting in response to these dramatic changes in the mail marketplace, we have reported a net loss in each of the last three fiscal years and expect to do so again this year.

In fiscal year 2009, total mail volume fell by an unprecedented 26 billion pieces, or 12.7 percent, from the previous year, to 177 billion pieces. This was the largest annual mail volume decline in postal history. Despite reductions in full time equivalent employees of 65,000, $6.1 billion in cost reductions, and a $4 billion reduction in the required 2009 payment of $5.4 billion to the Postal Service Retiree Health Benefits Fund (PSRHBF), the volume decline led to a net loss of $3.8 billion in 2009. This loss followed the net losses of $2.8 billion in 2008 and $5.1 billion in 2007, for a cumulative net loss of $11.7 billion in the last three fiscal years. These losses occurred even as our delivery network continued to expand to reach its current record size of more than 150 million delivery points.

Without critically needed fundamental changes, we expect significant and growing losses in fiscal year 2010 and each year into the near future. For FY 2010 alone, our financial plan estimates a revenue decline of roughly $2 billion and a net loss of $7.8 billion. (Year-to-date numbers through February, however, show us about $1 billion ahead of plan.) These projections assume there will be no changes this year in the number of mail delivery days per week or in the current retiree health benefits funding schedule.

The critical fiscal condition of the Postal Service in 2010 can largely be attributed to these factors: the diversion of letter mail to electronic alternatives; the ongoing effects of the economic recession; the statutory obligation to pre-fund retiree health benefits at an accelerated pace; and the restrictions on making adjustments to our operations network and cost structure. In effect, while we are funded like a commercial enterprise, we do not have the flexibility of a commercial enterprise needed to adjust our pricing and costs to a dynamically changing marketplace.

To bring the Postal Service out of its present crisis, we must implement fundamental changes that solve for all of these causative factors and address the part each has played in our current financial condition. Only by correcting for these can we bring our costs and revenues into better alignment so as to assure the long-term financial well being of the Postal Service and its ability to meet its mission to the American people.

Beginning in 2000, the Postal Service instituted a program of aggressive cost reductions from which it realized over $1 billion on average in annual savings in each succeeding year:

- Continued to invest in automation, energy-saving technologies, plant consolidation and other significant cost-reduction initiatives.

- Substantially reduced the career postal workforce by 164,000, while improving customer satisfaction and service performance.
- Paid down debt and reduced interest expense.
- Captured savings of 379 million workhours from 2000 to 2009 and realized eight straight years of productivity gains.

. However, even as these necessary cost reductions were underway, the Postal Accountability and Enhancement Act of 2006 (PAEA) imposed new costs, unique new requirements and important structural changes on the Postal Service. The PAEA:

- Established CPI-based price caps uniformly across all Market Dominant mail classes, which provide 88 percent of Postal Service revenue.
- Allowed greater pricing flexibility in Competitive mail classes, but that latitude extends to only about 12 percent of our business.
- Restricted the Postal Service’s ability to create new products and seek new sources of revenue.
- Maintained the prohibition on closing individual Post Offices solely because their costs exceed revenues.
- Required unique pre-funding of Retiree Health Benefits (RHB).

In comparison with the previous statutory scheme, which required the Postal Service to set rates to generate revenue adequate to cover its costs, the PAEA resulted in a system in which rate changes are constrained by the price cap, without reference to trends in either mail volumes or postal costs.

IV. Workhours

Lower mail volumes and a nation-wide hiring freeze were in large part responsible for the 115 million decrease in workhours in 2009, which represents an 8.4 percent reduction relative to 2008 workhours, and which equates to the equivalent of 65,000 employees. To put that in perspective, fewer than 20 percent of Fortune 500 companies have a <u>total</u> of 65,000 employees. Management initiatives and delivery route adjustments, initiated in response to the decline in workload, contributed to reductions in workhours in all major functions. These workhours reductions were in addition to the 50 million hour reduction from 2008. For FY 2010, our plan is to cut an additional $3.8 billion of costs, including the elimination of approximately 93 million more workhours—the equivalent of about 53,000 full-time employees.

V. Cash Flows and Debt

We experienced negative cash flow in two of the past three years. In 2009, we were able to fund obligations through increased debt and a last-minute $4 billion reduction to our Postal Service Retiree Health Benefit Fund (PSRHBF) payment. Our debt at September 30, 2009, was $10.2 billion. We project net debt outstanding at the end of 2010 to increase by $3 billion, but this increase may be insufficient to fund all obligations. If significant losses continue in 2011, the overall $15 billion debt limitation is likely to be insufficient.

For the second year in a row, the Postal Service is now confronting the threat of a liquidity crisis with conditions nearly identical to those of 2009. Although we believe that there are sufficient cash flows for ongoing operations, there is uncertainty as to whether, on September 30, 2010, we will have sufficient cash to fund our $5.5 billion PSRHBF payment required by the PAEA. If we cannot fund that payment, we will experience a cash shortfall.

As we did when confronting a potential liquidity crisis last year, we will continue to inform Congress on our financial outlook and of legislative changes that would help ensure the availability of cash at year-end. However, there can be no assurance that adjustments to the PSRHBF payment schedule will be granted by September 30, 2010, or at all.

VI. The Postal Service Business Model is Volume Dependent

We must recognize that the point of crisis reached today, manifested in the abrupt short-term deterioration of Postal Service finances, has deeper roots. While owing much to current economic conditions and the alteration in Americans' communications habits and preferences, our current financial condition is, nonetheless, also inherent in the Postal Service business model, first established in the Postal Reorganization Act, and then modified by the Postal Accountability and Enhancement Act (PAEA) of 2006.

In the legislated postal business model, the financial viability of the Postal Service as a wholly self-sustaining and independent enterprise implicitly assumed that Americans' use of mail would continue to grow each year along with the ever-expanding growth of the total American population and in proportion to or at a rate greater than the continuously expanding growth of residential and business addresses. In other words, the Postal Service would have sufficient volumes of its varied mail classes to derive sufficient revenues to realize the modest net income prescribed by postal legislation and regulation, and remain a financially viable American public service institution.

For decades, that basic model did serve the needs of the Postal Service, as mail volumes grew in concert with the growth in demands on our delivery network. Together with our continuous investment in efficiency and productivity, and with rate increases that reasonably tracked inflation, continuous mail volume growth allowed the Postal Service to meet increasingly high standards of service performance while adding new addresses to our delivery routes each year.

However, as discussed next, the dependable growth in mail volumes and revenues that once financed that network growth is no more. In its stead, over the last decade, we have witnessed the digital revolution in which the Internet, as well as digital communications and transactions of all kinds, has become a strong alternative to mail. Moreover, the price-cap constraints of the PAEA make it much more challenging to respond to these volume declines, as the previous ability to raise rates routinely in order to eliminate revenue shortfalls, regardless of their source, has evaporated.

VI. Current Revenue and Volume Can Not Support Our Current Networks

Total annual mail volume has now dropped more than 36 billion pieces from its 2006 peak of 213.1 billion. In fact, total mail volume now has dropped to levels last seen in 1994, when mail volume had to support a total of 124 million delivery points, not the 150 million delivery points it must support today. While economic factors drove the record 2009 drop in mail volume and affected all classes of mail, electronic diversion continued as a leading factor. We believe that the recession itself may have accelerated the diversion of First-Class Mail to the Internet. For FY 2010, we anticipate a further decline in total mail volume of approximately 10 billion pieces from 2009 levels. In 2010, revenue is also expected to continue to decrease, as declining volumes will not be offset by price increases for most services.

Without the fundamental changes to the unsustainable costs of our service schedule and of pre-funding retiree health benefits, we expect our liquidity challenge to continue as volumes and revenues fall and the mail mix becomes even more unfavorable. The major underlying trends, and their effects, are described in detail in the next sections.

A. First-Class Mail

Among mail classes, First-Class Mail provides the greatest contribution. In 2009, First-Class Mail generated two times the revenue and three times the contribution of Standard Mail, the next closest class. Historically, this “flagship” of the US Mail also registered the greatest volumes and delivered the largest portion of postal revenues. As structured in the Postal Service business model, the health of postal finances has always relied heavily on First-Class Mail revenues. However, Single-piece First-Class Mail volume has now been in decline for over a decade, and from 2005 through 2008, Standard Mail volume actually exceeded the volume of First-Class Mail.

In fiscal year 2009, revenue from First-Class Mail was $35.9 billion, or 6.0 percent less than in the previous year. Volume decreased 7.9 billion pieces, or 8.6 percent from the previous year. In 2008, First-Class Mail revenue decreased by 0.6 percent, and volume decreased by or 4.8 percent. Importantly, the 2008 revenue decrease occurred in spite of a 2008 rate increase and the residual effect of a prior rate increase. The most significant decline was in Single-piece First-Class letters, with a decrease of over three billion pieces.

The long-term continued decline in First-Class Mail volume reflects the impact of electronic diversion, as businesses, nonprofit organizations, governments and households continue to convert to electronic methods of communication and transactions. That loss of volume is permanent. When economic recovery occurs, growing use of the Internet and other digital communications will continue to suppress First-Class Mail volume growth. Overall, for 2010, First-Class Mail volume is expected to decline still further.

B. Standard Mail

Standard Mail is the other major pillar of postal finances, and together First-Class Mail and Standard Mail generated over three-quarters of all postal revenue in FY09. Standard Mail revenue decreased from $20.6 billon in FY08 to $17.4 billion in FY09, or 15.7 percent, as volume decreased 16.4 billion pieces, or 16.5 percent, from 2008. Standard Mail volume has been significantly impacted by the decline in advertising spending in all sectors of the economy as a result of the recession. We do, however, expect advertising mail to begin to increase and stabilize as the economy improves. We project that Standard Mail will have lost 25 percent of its historic peak volume by the time the recession ends, and that it may be a decade before Standard Mail volumes are likely to approach that level again.

C. Revenue Per Delivery Point Per Day

When evaluating the viability of the current postal delivery network, revenue per delivery point per day is one metric that quickly exposes the crux of problem. The assumption of volume growth approximately offsetting delivery point growth in the traditional business model is commensurate with an expectation of (inflation-adjusted) revenue per delivery point per day staying at least roughly constant over time. Over the last decade, however, two trends have had substantial negative effects on revenue per delivery point per day, and thereby frustrated that expectation. The first such trend is the absolute decline in the total number of pieces per delivery point per day. The second is the change in the mail mix within the types of pieces delivered.

In 2000, the average number of total pieces per delivery point per day was right around 5 pieces. In 2009, that number had dropped to slightly below 4 pieces, a decline of approximately 20 percent. Over that same period, though, inflation-adjusted revenue per delivery per day declined somewhat more, in the neighborhood of 25 percent. This was due primarily to the fact that the decline in higher-revenue First-Class Mail average pieces per delivery per day was above the 20 percent average for total mail, and the decline in lower-revenue Standard Mail average pieces per delivery per day was below that average. The shift in mail mix between 2000 and 2009 compounded the effect of the overall volume decline on average revenue per delivery point per day. Since both of those trends are anticipated to continue, the expectation can only be for further deterioration in average revenue per delivery per day. The only viable possibility on the horizon to reverse the effects of those trends on that fundamental measure of the viability of the delivery network is to reduce the number of delivery days per week, thereby lowering the denominator of the ratio.

D. Negative Trends

Not only do we expect that these negative trends in mail volumes and revenues will continue, but we also expect that the fixed costs of operating the postal delivery network will continue to increase. Given the alteration in our market brought on by the multiple digital alternatives to mail and the current statutory restrictions and requirements under which the Postal Service now operates, it is clear that, unless fundamental changes are instituted, our costs will continue to outstrip revenues and annual net losses will be inevitable over the long term.

This becomes evident upon examination of certain trends in the workforce and in costs. Since 2000, the Postal Service has reduced the overall number of career employees by 21 percent. Yet while the combined number of carriers (city and rural) has also declined over that period, the rate of decline for carriers is much lower than the average. Carriers declined by 10 percent, while all other employees (i.e., non-carriers) declined by 28 percent. Similarly, looking at costs, the direct costs of carriers constituted 27 percent of total Postal Service costs in 2000, but 31 percent in 2009. For purposes of cross-functional comparison, the direct cost of carriers totaled $22.2 billion in 2009, versus $13.1 billion for mail processing, $2.6 billion for window clerks, and $3.4 billion for custodial and maintenance. Together, all of these other major components of direct postal labor costs totaled $19.1 billion, well less than the carrier costs. Simply stated, as the Postal Service has continued to reduce the number of employees and expenses in these other functional areas that are smaller and more responsive to changes in volume, such as mail processing, the inherently greater fixed-cost nature of the carrier network prevents commensurate reductions in the larger costs of delivery.

Unless we address this new reality of postal economics with actions that will bring postal revenues and costs into alignment, we are destined to operate under a formula guaranteed to produce unceasing and unsustainable losses. At stake is the continuing viability of the Postal Service. This is what is leading us to consider all options for bringing costs and revenues into line, including re-examination of service features such as 6-day delivery that, if modified, could reap significant cost savings.

VII. The Decade Ending in 2020

The foregoing discussion demonstrates that financial pressures have been building over the last 5 years, and that postal management has been taking aggressive actions to offset losses through massive reductions in workhours and employees. On March 2, 2010, the Postal Service communicated its financial projections for the next decade. These projections show a long and steady decline in mail volumes and declines in revenue (in 2009 dollars). The declining revenues, coupled with growing expenses discussed above, are expected to result in cumulative losses of several hundred billion dollars over the next decade. In the March 2nd presentation, management restated its commitment to continue to grow revenues and reduce costs aggressively, and as result, we believe we can take steps to reduce these cumulative losses by approximately one-half. Fundamental changes in laws and our operating environment, though, are necessary to make closing the other half of this huge gap possible. The situation is so dire that no one action or concession by stakeholders can fill the void. Rather, we must take a balanced approach which includes efforts to:

- Restructure retiree health benefit prefunding
- Adjust delivery days
- Modernize retail access
- Establish a more flexible workforce
- Elevate the role of demand factors in pricing, and, in the short term, pursue a modest exigent price increase
- Expand the scope of product and service offerings
- Seek to streamline oversight and regulatory processes

This is not an either/or situation. We must both obtain short-term relief and change our business model to survive the next few years and to become profitable in the medium term, so that we can return to financial stability and begin to repay the $15 billion of debt that will be outstanding. Changing from 6-day to 5-day delivery is the only structural change we see that can reasonably promptly provide needed relief on a multi-year basis in amounts which begin to close the gap. Without this change, we see no other alternatives that will return us to financial stability that do not involve Government subsidies, which the Postal Service does not want, and presumably the Federal Government does not want either.

VIII. Proposed Service Change: Five-Day Delivery

The Postal Service recognizes the significance of changing to a five-day delivery schedule and would not propose it if six-day service could be supported by current volumes. The fact is, however, that there is no longer -- and there will not be -- sufficient mail volume and revenue to sustain six days of delivery per week. The change to a five-day delivery schedule that we present in this docket will substantially lower our annual operating costs and produce net savings estimated at a value of $3.1 billion each year and growing over the coming decade. This savings projection factors in a reduction in mail volume and a consequent $200 million reduction in annual contribution that would result from the change. A five-day delivery schedule will yield these needed savings by bringing costs and revenues per delivery into better balance and without degrading universal service standards or performance.

By eliminating delivery to street addresses on Saturdays, the lowest volume day, five-day delivery will restore average number of total mail pieces per delivery point per day to the level that it was at in 2003. This is still below the average as of 2000, but it is a significant increase above the current level. Based on a delivery network of 150 million addresses (130 million of which are street addresses, and 20 million of which are post office boxes), this shift to five-day delivery would help to re-balance the costs of delivery per day with the lower revenues now provided by reduced mail volumes and the permanent, unfavorable shifts in the mail mix. Annual operating cost savings that could result from a shift to five-day delivery are explained in the testimonies of witnesses Bradley (USPS-T-6) and Colvin (USPS-T-7) and total $3.3 billion. Witness Whiteman (USPS-T-9) estimates a net loss in contribution resulting from the volume effects of a switch to five-day delivery to be approximately $200 million. The net annual savings would be approximately $3.1 billion dollars.

The Postal Service could begin realizing some of the annual savings of $3.1 billion from five-day delivery as soon as 2011. After absorbing the estimated $110 million in implementation costs in 2011, full annual program savings could follow in 2012.

As presented in this docket, changing to a five-day delivery schedule would also provide the Postal Service with an extraordinary opportunity to accomplish another much needed fundamental change. If the Postal Service is able to act now, it will have the opportunity within a narrow window of time in which to more closely align its workforce through attrition with the needs of a five-day operation. A significant portion of the current workforce – 44 percent – is now eligible to retire or will become eligible between now and 2014. After then, the number of new retirement-eligible employees will fall dramatically. Changing soon to five-day delivery will allow the Postal Service to deploy resources in a way that complements these pending retirements. Positions would not have to be filled with the intention of ensuring staffing for six-day delivery, only to have many of those jobs eliminated in the future.

As we respond to the dire financial crisis that now threatens our viability, the Postal Service will pursue and seek to implement every reasonable savings and revenue opportunity that we can identify. The Postal Service has no basis for expecting current financial trends to reverse themselves. No single strategy will solve for all of the multiple causes of our financial crisis and we do not purport to attempt to do so with the service and operational changes we present in this docket. Rather, we recognize that the realities of the new postal market and the resulting postal financial condition demand that multiple strategies and options be developed, and that we undertake *all* options judged to have a reasonable chance to produce positive financial and service results in order to plug the hole. However, we know of no operational action other than this proposed change to a five-day delivery schedule that the Postal Service can take and can implement so quickly that would deliver such great benefit to our financial viability. For this reason, we believe that the Commission should issue an affirmative advisory opinion in this docket.

Conclusion

Recent history and present circumstances demand action now. It is clear that the business model and operating strictures established for the Postal Service have been overtaken by the realities of the new communications and mailing environment. The assumptions that are at the foundation of the Postal Service business model no longer hold. As we have seen, the Postal Service is now struggling under the combined economic and financial impacts of both the new mailing environment and the costs and restrictions imposed by statute. The historical constant growth in overall mail volume has been replaced by volume decreases and changes in the mail mix from the predominance of higher contribution First-Class Mail to the new dominance of Standard Mail with its lower contribution. This gross imbalance of growing network and institutional costs and falling mail volumes and revenues is now well established. It is unsustainable.

We cannot afford to wait for change in the expectation that the conditions of the new postal marketplace will resolve themselves in our favor on their own. Moreover, not only must the Postal Service make adjustments to allow it to achieve short-term breakeven, it must also make plans to generate additional net revenue to pay down its accumulated debts. To achieve the mission to which we are committed, to preserve universal service and performance standards, we must act now to stabilize Postal Service finances and, thereby, assure the continuing viability of this essential American resource.