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FIRST-CLASS MAIL AND PERIODICALS SERVICE STANDARD CHANGES, 2021	Docket No. N2021-1

DIRECT TESTIMONY OF CURTIS WHITEMAN

ON BEHALF OF THE

UNITED STATES POSTAL SERVICE

(USPS-T-2)

TABLE OF CONTENTS

AUTOBIOGRAPHICAL SKETCH

My name is Curtis Whiteman. I am currently serving as the Acting Director, Budget, reporting to the Senior Vice President, Finance and Strategy. I am responsible for developing and allocating expense budgets to fund field operations and monitoring performance against the plan.

I have spent my entire 16-year Postal Service career exclusively in Finance. I served in various staff and management positions, including Manager, Business Planning & Analysis, and Acting Manager, Strategic Business and Financial Planning. I also teach finance classes for the Postal Service's Management and Advanced Leadership programs.

I earned a Bachelor of Arts degree in Accounting from the University of Maryland, a Master of Business Administration degree from the University of Phoenix, and a Certificate of Business Analytics from The Wharton School, University of Pennsylvania. In addition, I am a graduate of the USPS Advanced Leadership program and am Lean Six Sigma Green Belt trained.

PURPOSE OF TESTIMONY

The purpose of my testimony is to furnish financial context for the Postal Service's proposed service standard changes. First, I will provide background on the Postal Service's recent and current financial condition and the need for the service standard changes. I will begin by showing trends in volume, net income/loss, and liquidity since 2007.[1] This will include 2020 results as well as the 2021 Integrated Financial Plan targets. Together, these realities have led the Postal Service to conclude that this initiative is necessary and in the long-term interests of all users of the mail.

Next, I will discuss the methodology that the Postal Service has used to estimate the cost savings potential of the initiative, and I will present the overall estimated change in cost.

Finally, I will compare the expected cost savings with the potential contribution loss to arrive at an estimate of the expected net financial impact.

[1] All references to years in this testimony refer to Postal Service fiscal years.

ASSOCIATED LIBRARY REFERENCES

I am sponsoring the following Library References, which are associated with this testimony:

USPS-LR-N2021-1-4	Calculating Transportation Cost Changes (Public Version)
USPS-LR-N2021-1-NP2	Calculating Transportation Cost Changes (Non-Public Version)

I. THE POSTAL SERVICE'S FINANCIAL SITUATION

Despite the fact that the Postal Service continues to provide the nation with a vital delivery platform that serves every American business and residential address, mail volumes are on the decline because of a dramatic shift in market dynamics over the last fifteen years. Due to increased use of electronic communications and the rapid growth of digital advertising, annual mail and package volumes have declined by 39 percent since 2006 to 129 billion pieces in 2020. Additionally, the Postal Service faces tough competition in its package business, both from traditional delivery companies and from current customers that have begun implementing their own delivery capabilities. These trends are well-established and are expected to continue to impact the Postal Service for the foreseeable future.

The following legal constraints limit our ability to respond to market forces:

- The universal service obligation, which requires, among other things, delivering mail six days per week throughout the nation and maintaining unprofitable retail locations. The universal service obligation results in significant costs for delivery and retail operations, which must grow notwithstanding declining mail volume.
- Mandatory participation in federal retiree and employee benefits programs, the costs of which are higher than most other employer benefits programs and generally grow faster than the rate of inflation.

- Other constraints on our ability to control our costs, such as the statutory requirement to engage in collective bargaining against a backdrop of binding arbitration.

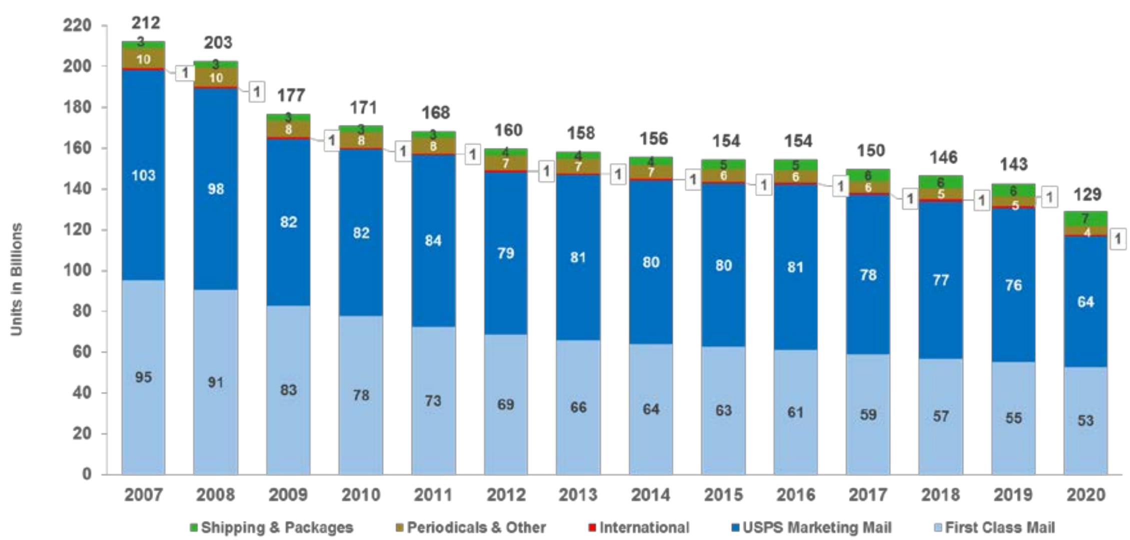
In combination, these factors have led to an enormous and growing financial deficit. Among other things, the Postal Service has incurred fourteen consecutive years of net losses, defaults on mandated retiree health benefits (RHB) and pension payments, a severely underfunded balance sheet, and a cash balance insufficient to make critical capital investments or to weather rapid revenue declines.

In 2020, our net loss was $9.2 billion. Our 2021 Integrated Financial Plan projects a net loss of $9.7 billion, absent legislative or regulatory reform. The gap between our total liabilities and total assets is expected to grow from $80.7 billion in FY2020 to $90.1 billion in FY2021, with the ratio growing from 325 percent to 386 percent. Our ratio of current liabilities to current assets is even higher, at 486 percent in FY2020. Without a combination of legislative and regulatory reforms, coupled with operational changes to reduce costs, the organization has no viable path to financial stability.

A. Recent History of Mail Volume Declines

The Postal Service depends upon revenues from its products and services to sustain operations and meet its universal service obligation. For decades, steady growth in mail volumes generated revenues that kept pace with increasing costs. Price increases were generally in line with inflation. That growth ended in 2006, when total volume peaked at 213 billion pieces. Since 2006, total annual volume has fallen by about 39 percent. In 2009 alone, total volume fell 26 billion pieces, or almost 13 percent, the largest annual percentage decline that the Postal Service has experienced since the 1930s. Mail volume did not rebound or stabilize after the Great Recession, as it did after other recessions; instead, for the first time in American postal history, mail volume continued to decline. Total volumes in 2020 (129 billion pieces) dropped by 13 billion pieces, or 9 percent, to their lowest level since 1983. These lost volumes, which are largely due to the proliferation of electronic media for bill presentment, payment, correspondence, and other communications, are not expected to return. Table 1 illustrates steady overall volume declines over the past fourteen years and demonstrates that the growth in the package volume has not offset the declines in our mail segments.

Table 1: Total Volumes, by Category



Source: U.S. Postal Service Revenue, Pieces, and Weight reports

The greatest volume decline has been experienced in First-Class Mail, our highest-contributing product, where volumes have declined by approximately 45 billion pieces, or 46 percent, since 2006. USPS Marketing Mail, which comprises the majority of our mail volumes, declined by more than 38 billion pieces (37 percent) from 2006 to 2020, mainly due to the increasing diversion of advertising spending from USPS Marketing Mail to digital media (the Internet, email, mobile, or social media).

Both First-Class Mail and USPS Marketing Mail were adversely affected by the COVID-19 pandemic in 2020. First-Class Mail volumes decreased by 9.2 percent and 5.7 percent in Quarters 3 and 4 of that year, compared to the same quarter in 2019, respectively. USPS Marketing Mail volumes decreased by 36.4 percent and 14.9 percent for the same periods. Although the COVID-19 pandemic was without doubt an extraordinary event, based on our experience following the Great Recession and the existing systemic trends, we deem it unlikely that volumes will return to past levels in future years.

A wide variety of communications media compete for the same types of transactions and communications that are conducted using our letter mail delivery services. The most significant competitor for First-Class Mail is digital communication, including email, social networking, telecommunications, and online bill payment and presentment.

For USPS Marketing Mail, digital forms of advertising, including digital mobile advertising and social media, are the most significant form of competition. Digital advertising's share of advertiser spend is forecasted to increase each year, while the portion captured by direct mail (postage costs only) is expected to decline. The continued trend toward digitization will put downward pressure on mail volumes for the foreseeable future.

B. The Current Business Model Results in an Unsustainable Financial Situation

Since 2007, we have suffered 14 years of consecutive net losses totaling $87.0 billion, with a $9.2 billion net loss in 2020 alone. Retirement-related expenses totaled a roughly comparable amount during that period ($84.2 billion), but it would be a mistake to attribute the net losses solely to such expenses. Structural forces in the marketplace and in our legal framework have also had a significant impact on our financial results. These structural factors include declines in high-contribution mail volume; a rigid system of market-dominant rate regulation, which has limited our ability to raise prices to offset the revenue impact of volume declines;[2] limited ability to introduce new products; and legislative restrictions on reducing operating costs, including the universal service obligation, mandatory participation in costly federal benefits programs, and a requirement to engage in collective bargaining against a backdrop of binding arbitration.

Despite the legislative constraints on our ability to control costs, we have been aggressive in managing costs that are within our control. Since 2006, we have reduced the total number of employees by 125,000 through attrition by such measures as restructuring delivery routes, reducing lobby hours at 13,000 underutilized retail offices, and consolidating mail processing at more than 360 facilities. Starting in 2011, our labor agreements have allowed us to increase our

[2] Although the Commission's recent modifications to the rate-regulation system will include additional rate authority based, in part, on volume decline, it has not yet taken effect; does not aim to offset the impact on the current rate base from past volume declines; and is designed to be conservative, rather than providing a complete adjustment in all cases.

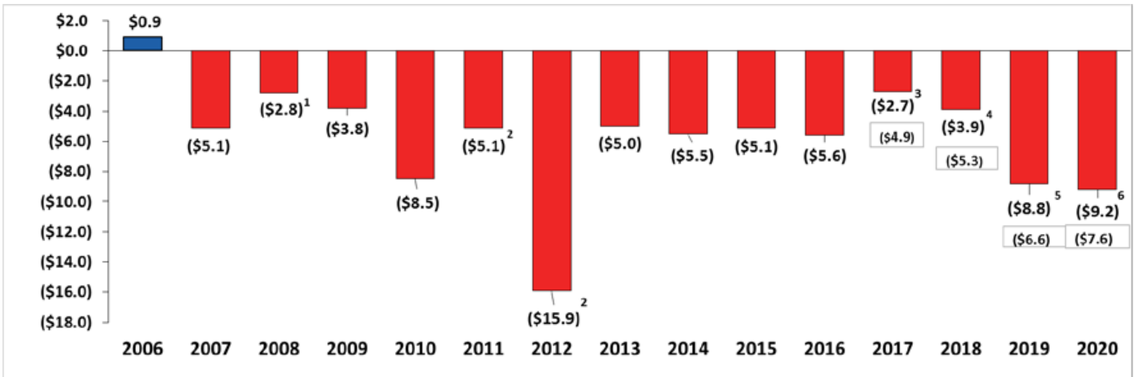
non-career workforce and to introduce a lower-tier wage schedule for new career employees. We have secured agreement from our unions on higher rates of employee contribution toward health benefits, to the point of parity with the rest of the federal government for most employees. The Postal Service must continue to pursue efforts to increase operational efficiency and reduce costs in order to ensure its financial sustainability.

Another mitigating factor in recent years has been growth in the e-commerce marketplace, leading to dramatically increased demand for package shipping services. In 2020, the Postal Service's Shipping and Packages services, which are almost entirely made up of competitive products, constituted 39 percent of operating revenues, compared to 11 percent in 2007, an increase of 255 percent.[3] Competitive products participate in the package delivery market and are subject to market forces. The competitive environment is highly dynamic and largely price-driven. This limits our ability to increase prices and revenues in this sector.

While significant cost reductions and growth in the package business have slowed the rate of financial decline, they have not been enough to reverse fourteen consecutive years of net losses.

[3] Part of this shift results from the reclassification of certain market-dominant products as competitive during the intervening years.

Table 2: Net Income/Loss, 2006-2020



1 - In 2009, $4.0 billion of RHB prefunding was deferred by Congress and was to be reevaluated in 2017.
2 - In September 30, 2011, Congress deferred the 2011 RHB prefunding expense of $5.5 billion until August 2012; it is included in the 2012 net loss.
3 - Includes a positive non-cash accounting adjustment for workers' compensation of $2.2 billion due to discount rate changes; absent this, net loss would be ($4.9 billion).
4 - Includes a positive non-cash accounting adjustment for workers' compensation of $1.4 billion due to discount rate changes; absent this, net loss would be ($5.3 billion).
5 – Includes a negative non-cash accounting adjustment for workers' compensation of $2.2 billion due to discount rate changes; absent this, net loss would be ($6.6 billion).
6 - Includes a negative non-cash accounting adjustment for workers' compensation of $1.6 billion due to discount rate changes; absent this, net loss would be ($7.6 billion).

Source: U.S. Postal Service Forms 10-K

As a result of those net losses, we have been forced to default on nearly $63.3 billion dollars in RHB and pension payments in order to retain enough cash to continue serving the American public for as long as possible. Beyond immediate liquidity, unless we can reverse the outlook of continuing net losses and replenishing the Postal Service's assets, the already staggering burden of liabilities will become completely unsustainable.

In sum, the Postal Service exists within an ongoing state of financial crisis. Mail volumes are in systemic decline and package volumes, though buoyed by a pandemic-related surge, are under increasing competitive pressure. This decline is reflective of a rapidly changing mailing and shipping environment. The Postal Service continues to have insufficient liquidity to fulfill its universal service obligations, fully fund all legally-required financial obligations, maintain a margin of safety to deal with contingencies, and make necessary capital investments. In order to remain financially sustainable and to continue providing the American public with critical postal services, legislative reform is necessary, but the Postal Service must also aggressively manage costs within its control.

II. ESTIMATED COST SAVINGS FROM SERVICE CHANGE

A. Methodology for Estimating the Annual Cost Changes Caused by a Change in Service Standards

The purpose of this section is to describe the methodology used to measure the expected annual changes in costs resulting from the proposed change in service standards. These cost changes are the result of a two-step process. First, as described in witness Cintron's testimony (USPS-T-1), the service standard change will result in a restructuring of the Postal Service's transportation network. Namely, both the required air capacity and required highway capacity will be reduced. Primarily, in the surface network, there will be a reduction in Inter-Area, Inter-Cluster, and Inter-P&DC highway capacity.[4] There will be no immediate change in the capacity of transportation connecting the Postal Service's Network Distribution Centers (NDCs) because products that travel primarily on the NDC network will not be impacted by this change in

[4] Inter-Area, Inter-Cluster, and Inter-P&DC are types of accounts within the Inter-SCF cost pool for highway transportation. These accounts are defined as follows:

Inter-Area accounts are used to record the expense for the transportation of mail between a postal facility (except a Network Distribution Center (NDC)) in one postal area and a postal facility (except a NDC) in a different area.

Inter-Cluster accounts are used to record the expense for the transportation of mail between a postal facility in one district and a postal facility in a different district, when both postal facilities are within the same postal area and neither are NDCs (not Inter-NDC).

Inter-P&DC accounts are used to record the expense for the transportation of mail between two postal processing and distribution plants (neither an NDC) within the service area of a postal district within a postal area.

service standards.[5] Second, this change in both highway and air capacity will result in a change in costs incurred for purchased highway and air transportation.

The relationship between cost and capacity has been the subject of ongoing study over the past several decades, and these econometric studies have been presented to and approved by the Postal Regulatory Commission on several occasions for use in regulatory costing.[6] For air transportation, the cost generally varies in proportion to volume, due to the nature of the contracts.[7] For highway transportation, the cost-to-capacity relationship was measured through an econometric analysis based on contract data from the Transportation Contract Support System (TCSS). This analysis includes consideration of route length and postal area, in addition to the cost incurred for purchasing some amount of highway capacity, measured in cubic foot-miles.[8] This testimony will rely on these established methods, as they represent a sound economic basis for calculating the expected cost savings resulting from the planned operational changes. In addition, the analysis of cost savings described in this section will hold constant the volume of mail being transported, as has been done in

[5] Direct Testimony of Robert Cintron on Behalf of the United States Postal Service (USPS-T-1), PRC Docket No. N2021-1 (Apr. 21, 2021), at 15-17.

[6] *See, e.g.*, Order No. 2180, Order on Analytical Principles Used in Periodic Reporting (Proposals Three Through Eight), PRC Docket No. RM2014-6 (Sept. 10, 2014), at 15; Direct Testimony of Michael D. Bradley on Behalf of United States Postal Service (USPS-T-18), PRC Docket No. R2000-1 (Jan. 12, 2000), at 1-13 (recounting history of the methodology from before Docket No. R80-1 to Docket No. R97-1).

[7] Summary Description of USPS Development of Costs by Segments and Components, Fiscal Year 2019 (July 1, 2020), Microsoft Word file “CS14-19.docx”, at 14-3.

[8] USPS-RM2014-6/1, Public Material Relating to Proposal Six (June 20, 2014), Microsoft Word file “Rpt.Updat.PHT.Cost.Cap.Variab.docx”, at 12.

previous similar analyses, to avoid any confounding effects of introducing volume reductions in addition to operational changes.[9]

B. Cost Changes Arising from the Change in Service Standards

1. Cost Changes Resulting from Changes in Air Capacity

As a result of the proposed change in service standards, the Postal Service expects a reduction of 49.3 percent in First-Class Mail pounds flown.[10] This reduction will be spread across multiple air carriers, each of which charges a different rate per pound flown (or per cubic foot flown). With one small exception, air transportation costs have been shown to vary in proportion with volume, due to the nature of the contracts with the carriers.[11] Therefore, the reduction in capacity will imply a proportional reduction in purchased air transportation cost. In other words, the savings resulting from the reduction in air capacity can be calculated for each carrier by multiplying the expected percent reduction in units flown by the carrier's total cost. Witness Hagenstein provides the expected percent reduction in pounds of First-Class Mail flown. This reduction is then converted into the percent reduction in total air capacity by carrier. Details of the methodology used for this calculation are included in the preface to Library Reference USPS-LR-N2021-1-NP2. As stated above, the percent reduction in

[9] *See* Direct Testimony of Michael D. Bradley on Behalf of the United States Postal Service (USPS-T-10), PRC Docket No. N2012-1 (Dec. 5, 2011), at 2.

[10] Library Reference USPS-LR-N2021-1-3, Microsoft Excel file "3_SSD_5D_Vol_Impacts_CONUS.xlsx", tab "Air_Finance_Summary".

[11] Summary Description of USPS Development of Costs by Segments and Components, Fiscal Year 2019 (July 1, 2020), Microsoft Word file "CS14-19.docx", at 14-3. The exception – payments to FedEx and UPS for failure to meet minimum volume commitments – is treated as an institutional cost and accounts for only a 0.4-percentage point diminution in what is otherwise a 100-percent volume-variability ratio. *Id.* at 14-2, 14-3. Moreover, there is sufficient lead time until implementation to adjust the network appropriately and meet new planned minimums.

capacity for each carrier is multiplied by the total cost for that carrier to calculate the proportional reduction in cost.

Combining the savings from all air carriers provides a total air transportation savings of $196.1 million per year expected as a result of the reduction in air capacity. Supporting workbooks containing the calculations described in this section are filed in Library Reference USPS-LR-N2021-1-NP2, Calculating Transportation Cost Changes (Non-Public Version).[12]

2. Cost Changes Resulting from Changes in Highway Capacity

In addition to the reduction in required air capacity, the proposed change in service standards will result in changes in the highway network. As calculated in Witness Hagenstein's supporting workpapers, the required surface capacity will decrease as the proposed service standards allow for more efficient travel paths for current surface volumes. This added efficiency more than offsets any increases in surface capacity that may have arisen as a result of shifting mail out of air and into the highway network.

The relationship of highway capacity to cost has been studied and documented with the Commission, most recently in Docket No. RM2014-6. In the highway network, a certain percent change in capacity yields a lower percent change in cost. This relationship is measured by the cost-to-capacity variability, which lies between 85 and 95 percent for long-haul highway transportation.[13] In

[12] Corresponding public versions of the supporting workbooks are filed in USPS-LR-N2021-1-4 with commercially sensitive data redacted.

[13] USPS-RM2014-6/1, Public Material Relating to Proposal Six (June 20, 2014), Microsoft Word file "Rpt.Updat.PHT.Cost.Cap.Variab.docx", at 28, 31 (Tables 7 & 10).

other words, if capacity increases by 10 percent, cost will increase by only 8.5 to 9.5 percent, depending on the contract type. Mathematically, the relationship between cost and capacity is calculated as:

$$\%\Delta Cost_i = \varepsilon_i * \%\Delta Capacity_i,$$

where ε is the cost-to-capacity variability, and capacity is measured in cubic foot-miles.

Given that, the total cost savings can be calculated as:

$$CostSavings_i = \varepsilon_i * [\%\Delta CFM] * BaselineCost_i.$$

The majority of the cost savings due to the proposed change in service standards is within Inter-Area contracts. Witness Hagenstein calculates a 6.6 percent decrease in capacity for this network.[14] As described above, the corresponding cost decrease can be calculated by multiplying the percent decrease in capacity by the relevant cost-to-capacity variability, which is 89.9 percent for Inter-Area transportation.[15] Therefore, a 6.6 percent decrease in capacity implies a 5.9 percent decrease in cost. Given that the baseline cost for these accounts is $1.09 billion, the expected annual cost savings in the Inter-Area surface network is $64.8 million.

The cost savings in the Inter-Cluster and Inter-P&DC networks are calculated in a similar manner. Witness Hagenstein calculates an anticipated 3.6 percent reduction in the Inter-Cluster capacity and a 7.2 percent reduction in the

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[14] Library Reference USPS-LR-N2021-1-3, Microsoft Excel file “3_SSD_5D_Vol_Impacts_CONUS.xlsx”, tab “Finance_Summary Surface”.

[15] USPS-RM2014-6/1, Public Material Relating to Proposal Six (June 20, 2014), Microsoft Word file “Rpt.Updat.PHT.Cost.Cap.Variab.docx”, at 31 (Table 10).

Inter-P&DC capacity.[16] The cost-to-capacity variability is 89.1 percent for Inter-Cluster transportation and 85.0 percent for Inter-P&DC transportation.[17] Thus, the associated baseline costs and savings for Inter-Cluster and Inter-P&DC transportation are calculated as described above and summarized in Table 3 below.

Table 3: Inter-Cluster and Inter-P&DC Cost Savings

Contract Type	Cost-to-Capacity Variability	Capacity Change	Baseline Cost	Cost Change
Inter-Cluster	89.1%	-3.6%	$249 million	$8.0 million
Inter-P&DC	85.0%	-7.2%	$174 million	$10.7 million

In total, combining the impacts to the highway network capacity between Inter-Area, Inter-Cluster, and Inter-P&DC contracts results in a decrease of $83.5 million in annual purchased highway transportation cost.

3. Net Impact on Purchased Transportation Cost

The proposed change in service standards will impact purchased transportation by reducing capacity needs in both air and highway transportation. In summary, the decrease in annual cost for air transportation of $196.1 million and for highway transportation of $83.5 million results in a total annual cost savings of $279.6 million for purchased transportation.

[16] Library Reference USPS-LR-N2021-1-3, Microsoft Excel file "3_SSD_5D_Vol_Impacts_CONUS.xlsx", tab "Finance_Summary Surface".

[17] USPS-RM2014-6/1, Public Material Relating to Proposal Six (June 20, 2014), Microsoft Word file "Rpt.Updat.PHT.Cost.Cap.Variab.docx", at 31 (Table 10).

III. NET FINANCIAL IMPACT OF INITIATIVE

The output of the costing models shows an expected decrease in annual cost of $279.6 million. These projected cost savings are expected to be partially offset by the potential lost contribution due to the longer delivery standard. As described by witnesses Monteith (USPS-T-4) and Thress (USPS-T-5), the estimated net decrease in annual contribution is projected at $104.8 million. Subtracting this figure from the $279.6 million in estimated annual net cost savings yields an estimated overall improvement in net income of $174.8 million.

IV. CONCLUSION

As shown above, the current and recent net losses cannot be maintained. Without significant, sustained efforts to address our operating costs, along with other changes, our financial condition will continue to deteriorate. This initiative to reduce the costs of our transportation network is one of many things needed to offset these losses and help improve our overall financial strength.