Postal Rate Commission
Submitted 10/26/2006 2:13 pm
Filing ID: 54534
Accepted 10/26/2006

BEFORE THE
POSTAL RATE COMMISSION
WASHINGTON, D.C. 20268-0001

Postal Rate and Fee Changes, 2006) Docket No. R2006-1

DIRECT TESTIMONY OF

LAWRENCE G. BUC

ON BEHALF OF

DIRECT MARKETING ASSOCIATION, INC.
ALLIANCE OF NONPROFIT MAILERS
AMERICAN BANKERS ASSOCIATION
ASSOCIATION FOR POSTAL COMMERCE
CONTINUITY SHIPPERS ASSOCIATION
DMA NONPROFIT FEDERATION
DOW JONES & COMPANY, INC.
DST MAILING SERVICES, INC.
MAGAZINE PUBLISHERS OF AMERICA, INC.
THE MCGRAW-HILL COMPANIES, INC.
MAIL FULFILLMENT SERVICES ASSOCIATION
MAIL ORDER ASSOCIATION OF AMERICA
MAJOR MAILERS ASSOCIATION
NATIONAL NEWSPAPER ASSOCIATION
NATIONAL POSTAL POLICY COUNCIL
PARCEL SHIPPERS ASSOCIATION
PITNEY BOWES, INC.

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September 6, 2006
(Revised October 26, 2006)

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AUTOBIOGRAPHICAL SKETCH

My name is Lawrence G. Buc. I am the President of SLS Consulting, Inc. (“SLS”), a Washington, D.C., consulting firm specializing in postal economics.

I have participated in rate and classification cases of the United States Postal Service (“Postal Service”) for over 30 years. I joined the Revenue and Cost Analysis Division of the Postal Service in March of 1975 and have analyzed postal issues ever since. I have also been employed by the United States Postal Rate Commission (“Commission”) and have been retained by private clients for consultations on postal topics.

This is the ninth case in which I have submitted testimony to the Commission. I have testified previously in four rate cases (R84-1, R90-1, R97-1, and R2000-1), three mail classifications cases (MC76-1, MC77-2, and MC2004-3), and in one complaint case (C99-4). I have testified on behalf of the Postal Service, the Office of the Consumer Advocate, and a number of intervenors.

I attended Brown University and graduated in 1968 with an A.B. with honors in mathematics and economics. In 1978, I received an M.A. degree in economics from the George Washington University of America. While there, I was a member of Omicron Delta Epsilon, the national honorary economics society. I am a member of the American Economic Association.

I. PURPOSE AND SCOPE

In my testimony, I will show that the Postal Service has overstated the revenue requirement for the Test Year. Section II of my testimony will show that the Postal Service has overstated its costs because it has underestimated cost reductions for supervisors. Section III will show that the Revenue Requirement is excessive because it results in a net surplus of almost $173 million; rates should be reduced to eliminate this surplus. Section IV will show that the Postal Service will likely end Fiscal Year 2006 in better financial condition than is estimated in the Roll Forward and that for Fiscal Years 2007 and 2008 should be adjusted to take this information into account. Section V will show that the Postal Service has overstated its contingency needs and its contingency request.

II. THE POSTAL SERVICE HAS OVERSTATED ITS COSTS BY UNDERSTATING COST REDUCTIONS FOR SUPERVISORS IN FY 2006, FY 2007, AND THE TEST YEAR

According to the Postal Service, Cost Reduction Programs enable it to save 9,951.1 clerk and mailhandler **workyears** in FY 2006 through what the Postal Service labels as Section 1A programs. Cost reduction programs also enable it save 8,955.9 clerk and mailhandler **workyears** in these programs in FY 2007, and 5,106.4 clerk and mailhandler **workyears** in the Test Year. However, the Postal Service claims that these truly impressive savings in craft labor will not enable it to save even a **single <u>supervisor</u> workhour** in any of these three years. *See* USPS-LR-L-49, L49_R2006_8hr.xls, Attachments D, E, and F. This claim is simply not credible.

The Postal Service clearly understands that supervisory workhours are a function of the workhours of the craft supervised. For example, they use this relationship to "roll costs forward" from the base year to the test year. Thus, when clerk and mailhandler costs change in response to changes in volumes, supervisor costs change in exactly the same proportion.

Moreover, the Postal Service recognizes that, as a general matter of cost causality, supervisory workhours are a function of craft workhours. For example, in describing supervisors of mail processing, the Service writes:

> "The workhours, and therefore the costs, for firstline Supervision are largely a function of the workhour-related costs of the supervised activities and supervisory span of control (number of employees per supervisor). Mail processing supervisors have a span of control that is essentially constant in a given work organization structure…. It is recognized that a change in employee workhours, caused by a change in mail volume, may not be accompanied immediately by a corresponding change in firstline supervisory workhours. However, for any substantial or prolonged change in the level of nonsupervisory employee effort for a given work activity, there will be an accompanying change in firstline supervisory requirements." USPS-LR-L-1, page 2-2.

Thus, the Postal Service accepts the general proposition that changes in supervisory hours should reflect changes in craft hours.

On the other hand, the Service points out that as the work or the organization changes, the span of control may not remain constant:

> "When measured solely in terms of number of employees per supervisor, however, span of control may change in circumstances of a changing work organization structure, such as when new programs or new technologies are implemented. In such circumstances, a more meaningful concept of span of control may focus on the amount and type of the mailflow for which the supervisor is responsible." USPS-LR-L-1, page 2-2.

The trouble is that the Service then uses the possibility that supervisor costs may not vary in direct proportion to supervised cost as an excuse for not making any reduction in supervisor costs as a result of changes in supervised costs. And it does so without having provided any information on the degree to which Cost Reduction Programs actually change the work organization structure or implement technologies that are sufficiently different to change the way work is organized. Some Cost Reduction

Programs may make such changes, but clearly many do not. For example, a description of the Letter Recognition Enhancement Program reads:

> "LETTER RECOGNITION ENHANCEMENT PROGRAM (LREP) – Recent programs, such as the Remote Computer Reader (RCR) Handwriting Recognition Upgrade, RCR 2000, and the Recognition Improvement Program (RIP2), have been successful in improving recognition capabilities. This program is further enhancing the handwritten and machine-print address recognition technology used in letter mail automation equipment (i.e., OCRs and RCRs). It may increase the total system recognition rate by up to 11 percentage points.
>
> "The projected savings are based on improvements to the total system recognition capability achieved through enhancements to existing OCR and/or RCR equipment. Four software releases/improvements have been made under this program per the following timeline: (1) November 2002; (2) August 2003; (3) September 2004; and (4) November 2004. Additional incremental improvements were deployed through February 2006." USPS-LR-L-49. Section 1A, page 7.

From this description, it is hard to infer that this Cost Reduction Program changes technologies sufficiently to change the organizational structure or the span of control of a supervisor. The plain English reading says that the new software will improve the performance of existing machines. In this circumstance, supervisors should be reduced as craft labor is reduced.

Of course, some Cost Reduction Programs do introduce new technology, but even some of these do not seem too radical enough to substantially effect workflows and organizations. For example, a description of the Automatic Flats Tray Lidders (AFTLs) reads:

> "AUTOMATIC FLATS TRAY LIDDERS (AFTLs) – This program will deploy Automatic Flats Tray Lidders (AFTLs) for use in dispatch operations nationwide. A total

> of 120 AFTLs will be deployed including 119 operational units and 1 training system. The AFTL is a self-contained mechanized system that will be installed either in-line or as a standalone device. It will eliminate the need to manually put lids on flat trays during dispatch operations, significantly reducing labor requirements associated with the current operation.
>
> "With an AFTL, flat trays ready for dispatch can be fed manually (standalone) or automatically from a tray line (in-line). The AFTL design includes a staging section where at least 400 flats tray lids can be stored. The machine will access a stack of flats tray lids from the staging section, pick a lid, fold two flaps, and insert the lid into the tray. The tray is then automatically passed onto the next processing operation for banding and/or airline assignment. In-line installations can be fed and swept automatically, and require about 15 minutes of manual labor per hour to restock the lids." USPS-LR-L-49. Section 1A, page 13.

And although I did not try to develop a method for determining which of the Cost Reduction Programs will change the work organization structure and which will not, a reading of all of them indicates that many will not.

Witness Loutsch also elaborates on the theme that cost reductions in supervisory labor do not necessarily track cost reductions in craft labor:

> "Between specific cost reduction programs and BPI, the Postal Service identifies realizable cost savings for technical personnel and supervisors. Cost reduction program implementations and supervision of operations frequently require additional supervisory time and attention in order to capture cost savings, to maintain service, and to ensure operating efficiencies. Therefore, the Postal Service specifically examines a program's cost savings opportunities, including those relating to Cost Segment 2, rather than making assumptions that supervisor costs follow in lockstep with estimated changes in craft staffing levels. Most cost reduction programs result in changes to the work environment. While a supervisor may have less people to supervise in the new environment, other responsibilities related to the new equipment and/or a changed environment add to a supervisor's workload.

> There are also ongoing responsibilities that do not change as a result of fewer employees, e.g., budget, safety, operating performance data monitoring, and coordination of mail flows. While not directly related to specific programs, supervisory, technical, and administrative savings are being pursued via the BPI/LMI processes."
> USPS-T-6 at 31, as revised on 7/31/2006.

Unfortunately, the Postal Service has not performed any analysis of whether and how supervisory hours change in response to changes in craft hours. When asked to "Please provide any empiric studies or analyses that you have performed showing that cost reductions programs will not affect the number of supervisors proportionate to the effect of these cost reduction programs on the crafts supervised" witness Loutsch responded "I have been informed that no such studies have been performed." DMA/USPS-T6-27, Tr. 2/167. Given that cost reductions programs for clerks and mailhandlers alone save the Postal Service $710 million in FY 2006, $756 million in FY 2007 (after rates), and $509 million in TYAR, and given that supervisor costs amount to over $4 billion in FY 2006, 2007, and TYAR (USPS-T-6 at 40, Table 26), I made the kind of study that the Postal Service had seen fit not to make.

I started with an analysis of job descriptions provided in response to DMA/USPS-T6-21(c), Tr. 2/146. Each position description includes a Functional Purpose and Duties and Responsibilities. For example, the position described as SUPERVISOR, DISTRIBUTION OPERATIONS, EAS-17, lists ten duties and responsibilities. The first, second, sixth, eighth, and tenth points clearly show that much of the work for this position is a function of the number of employees supervised. Tr. 2/148. This description is neither surprising nor unexpected given that supervisory costs do change proportionately with craft costs when changes in craft costs are induced by changes in mail volume.

The functional purpose for SUPV CUSTOMER SERVICES EAS-17 also shows that supervising people is the main responsibility:

> "Supervises a group of employees in the delivery, collection, and distribution of mail, and in window service activities within a post office, station or branch, or detached unit." Tr. 2/150.

Although the Postal Service may not have performed any analysis of whether and how supervisors hours change in response to changes in craft hours, their aggressive cost reduction programs over the last several years provide a natural experiment on this topic. Since 1999, total employee workhours, excluding those of Postmasters and Supervisors, have been reduced by 11.4 percent; in this same period of time, supervisory hours have been reduced by 9.5 percent.[1] Thus, it is manifest in the data that reductions in craft labor are accompanied by reductions in supervisory hours.

Based on this clear evidence, the Commission should adjust the Postal Service's Cost Reduction and Other Program estimates for FY 2006, 2007, and TYAR so that Cost Reductions and Other Programs for supervisors would be based on Cost Reduction and Other Programs for the crafts supervised. In doing so, it should net out the Function 1, 2, 3, and 4 BPI/LMI programs since these would now be reflected in the adjusted Cost Reduction and Other Programs for supervisors. However, it should retain all non-operational Cost Reduction Programs (Section 1B) and non-operational Other Programs (Section 2B.) These relate to Human Capital Enterprise HR Shared Services,

[1] These calculations were made using data provided by the Postal Service in its filings with the Commission and confirmed in witness Loutsch's response to DMA interrogatory DMA/USPS-T6-20(b), Tr. 2/143. For the convenience of the Commission and all interested parties, Table 13, referenced in this interrogatory response, is attached hereto as Exhibit DMA-1.

EEO Staff Shift, and Supply Chain Management and are technical rather than supervisory functions and are not related to crafts supervised. *See* USPS-LR-L-49. Section 1B, pages 24 and 25. It should also retain all Cost Reductions and Other Programs for Headquarters Programs and Zero Base Adjustments for the same reason. *See* USPS-LR-L-49, Section 1B, pages 28 and 29.

After making these adjustments, the Commission should also adjust TYAR equity to reflect the fact that with lower costs in FY 2006 and 2007, net income will be higher for each of these years and for the Test Year.

III. THE POSTAL SERVICE'S PROPOSED RATES LEAD TO AN EXCESSIVE SURPLUS

The Postal Reorganization Act limits the amount of revenue the Postal Service may collect in rates and fees…

> "Except as otherwise provided, the Governors are authorized to establish reasonable and equitable classes of mail and reasonable and equitable rates of postage and fees for postal services in accordance with the provisions of this chapter. Postal rates and fees shall be reasonable and equitable and sufficient to enable the Postal Service under honest, efficient, and economical management to maintain and continue the development of postal services of the kind and quality adapted to the needs of the United States. Postal rates and fees shall provide sufficient revenues so that the total estimated income and appropriations to the Postal Service **will equal as nearly as practicable** total estimated costs of the Postal Service." 39 USC §3621 (emphasis added).

Based on the revised testimony of witness Loutsch, the Postal Service will enjoy an extremely large TYAR net surplus: $173 million. USPS-T-6 (REVISED), Exhibit USPS 6A. A net surplus of $173 million does not appear to meet the plain English requirements of the Act. Further, it is plainly inconsistent with the surplus/deficiency forecasts for previous cases.

Table 1 below, shows the estimated surplus/deficiency in the Test Year After Rates, the revenue requirement for the Test Year After Rates, and my calculation of the surplus or deficiency as a percentage of the revenue requirement for this case and the 11 previous rate cases (I was unable to locate the data for R74-1). As the table shows, a surplus of $173 million is very inconsistent with historical values for surplus/deficits. Before this, the largest surplus/deficit was $112 million in R2005-1 but the size of this surplus was a function of the Across-the-Board nature of the case. The Service could not have mitigated this surplus in its request and still retained the essential nature of the case. Excluding this anomaly, the next largest surplus is $42 million, or 24 percent of the size of this one. And three of the surplus/deficits were within $10 million of breakeven, thereby demonstrating that small surplus/deficits are practicable.

Given that the absolute size of the surplus/deficit is arguably less important than its percentage of the revenue requirement, I calculated this metric. As the table shows, all of the results are small, but here again, the R2006-1 number clearly stands out as an outlier. It is twice as big as the next closest (again excluding R2005-1) and a much larger multiple of most of the others.

Table 1: TYAR Estimated Surplus/Deficiency and Revenue Requirement

Docket	**Surplus/ Deficiency (millions)**	**Revenue Requirement (millions)**	**Sur/Def as Percent Of RR**
R 76-1	$11.7	$14,170.8	0.083%
R 77-1	-$19.6	$17,642.0	-0.111%
R 80-1	$1.0	$22,962.7	0.004%
R 84-1	-$24.0	$29,339.3	-0.082%
R 87-1	-$18.4	$38,844.9	-0.047%
R 90-1	-$6.8	$48,108.7	-0.014%
R 94-1	-$0.8	$54,570.2	-0.001%
R 97-1	$41.9	$61,603.9	0.068%

R 2000-1	-$21.8	$69,138.7	-0.032%
R 2001-1	$33.1	$74,806.7	0.044%
R 2005-1	$112.0	$72,611.2	0.154%
R 2006-1	$172.6	$77,511.0	0.222%

Source: DMA-LR-1, Tab 8, Comparative Analysis of USPS Revenue Requirement Requests

One could easily argue that the appropriate revenue/surplus objective should be zero. And there is no reason why rates could not be developed to meet this objective: in fact in R80-1 and R94-1, the Postal Service came within $1 million of breakeven. Surely, this is a practicable number and the Commission should reduce rates by enough so that there is no surplus in TYAR.

IV. ACTUAL FINANCIAL RESULTS SHOW THAT THE ROLLFORWARD SHOULD BE ADJUSTED FOR FY 2006, FY 2007 AND THE TEST YEAR

The Postal Service estimates that it will lose $2.143 billion in FY 2006. USPS-T-6 (REVISED), Exhibit USPS 6A. Through the end of July, it had lost only $1.161 billion. July Financial and Operating Statements at http://www.usps.com/financials/_pdf/FY2006_july.pdf. Thus, to reach its estimated loss for the year, it would have to lose an additional $982 million or average losses of almost $500 million per month. This result seems unlikely.

Fortunately, speculation on the size of the loss is unnecessary. Well in advance of the time the Commission will issue an Opinion and Recommended Decision in this case, financial results for 2006 should be available since

> ". . . the September FOS will be released in conjunction with the FY 2006 Annual Report, which is published within a reasonable timeframe after the December Board of Governors' meeting. A specific issuance date has not yet been determined. DMA/USPS-T6-19, Tr. 2/142.

Given that in 2005 the Postal Service filed the Financial and Operating Statement for September with the Commission on December 9, 2005, a "reasonable timeframe" should make the results available before the end of the year even though "a specific issuance date has not yet been determined."

If net income is meaningfully better than the USPS estimate and this improved result appears not to be due to a one-time event, the Commission should take this fact into account in its estimates of FY 2007 and Test Year income.

V. THE CONTINGENCY IS OVERSTATED

Under the Postal Reorganization Act, the revenue requirement includes "a reasonable provision for contingencies." 39 U.S.C. §3621. In this case the Postal Service has requested a contingency of one percent. Although this request may appear reasonable by historical standards, a deeper analysis will show that it is excessive under the circumstances of this case. A more reasonable contingency, which would reflect the Service's strong financial condition, would be zero. I urge the Commission to review the contingency request and to recommend rates based on a zero percent contingency.

The Commission has both the authority and the obligation to review the Postal Service's revenue requirement request, including the contingency portion of that request. As the Commission wrote in its R2000-1 Opinion:

> "Once again, to the extent that the Postal Service is advancing the argument that the estimates of required revenue contained in its Request are immune from inquiry and appraisal on the record, or that the Commission's recommendations must approve them regardless of their record support, the Commission must respectfully agree to continue disagreeing in this area. The Supreme Court's decision in NAGCP IV, also cited by the Postal Service, states:
>
> > 'Although the Postal Reorganization Act divides ratemaking responsibility between two agencies, the legislative history demonstrates "that ratemaking . . . authority [was] vested primarily in [the] Postal Rate Commission." [Citations omitted.]

> The structure of the Act supports this view. While the Postal Service has *final* responsibility for guaranteeing that total revenues equal total costs, the Rate Commission determines the proportion of the revenue that should be raised by each class of mail.'

"462 U.S. at 821. (Emphasis added.) (Footnote omitted.) The Commission's view of its and the Governors' statutory responsibilities regarding the revenue requirement is fully compatible with this declaration. The Governors, in consultation with postal management, decide the magnitude of required revenues to include in Requests, in accordance with § 3621. They also exercise discretion to act on the Commission's recommendations pursuant to § 3625; should they find, after resubmission of the Request, that the rates recommended in the decision on reconsideration will yield insufficient total revenues, they may modify the Commission's recommendations in accordance with the record and the policies of Chapter 36. In the intermediate process that the Commission is directed to conduct, revenue requirement matters are subject to the same substantive, on-the-record review as are other issues, and the Commission will make substantive, but not final, determinations and construct its recommendations accordingly." PRC Op. R2000-1 at para. 2149 (footnotes omitted).

In reviewing the contingency, the Commission has long and consistently held that the financial position of the Postal Service is critical. About 30 years ago, in describing the proper size of the contingency, the Commission wrote…

"We must also take into account, in this connection, the ability of the Postal Service to absorb the consequences of erroneous predictions of costs and revenues. … We believe that the seriousness of the potential consequences of error in prediction is an appropriate factor to be taken into account in fixing the contingency allowance." PRC Op. R76-1 at 57.

Consistent with this position, in the next case, the Commission wrote

". . . we stated that a critical factor in determining the amount of contingency provision is the relative ability of

> the PostalService to absorb unforeseen expense increases and revenue shortfalls." PRC Op. R77-1 at 25.

The Commission reemphasized this theme ten years later:

> "In our prior opinions in omnibus rate proceeding we have recognized that the contingency reserve has two basic purposes. The first is to provide insurance against the possibility of a test year deficit resulting from misestimates of test year accrued revenue and expenses. The second is to protect against the possibility of a test year deficit resulting from unforeseeable events not capable of being prevented through honest, efficient, and economical management, *See* PRC Op. R84-1 at para. 1017. Because these are its purposes, a critical factor in determining the amount of the contingency provision is the relative ability of the Postal Service to absorb unforeseen expense increases and revenue shortfalls. *See* PRC. OP. R77-1 at 25." PRC Op. R87-1 at para. 2067.

Finally, in R2000-1, the Commission again emphasized the point:

> "Lacking any additional empirical information for guidance on an appropriate contingency provision, the Commission must evaluate the subjective claims of risk the Postal Service makes in support of an increased contingency provision. As in past cases, the Commission assesses these subjective claims by examining evidence bearing on the Postal Service's financial conditions, the state of the national economy, and other relevant factors." PRC Op. R2000-1 at para. 2160 (*citing* PRC Op. R84-1 at para. 1051).

The contingency proposed by the Postal Service in this case ignores this aspect of determining the contingency. Quite simply, the Postal Service's financial projections of its TYAR financial condition, as compared to projections in previous rate cases, would support a much smaller contingency. For example, with a full one percent contingency, After Rates 2008 equity will be $2.266 billion. The only other time the Service requested a one percent contingency was in R97-1, when its projected TYAR equity was a negative $1.499 billion. Thus, with over $3.75 billion in additional equity in the Test Year in this case as compared to R97-1, the Postal Service is certainly in a much better position to absorb the consequence of any adverse outcomes that might occur.

Table 2, below, shows projected TYAR equity as well as the percentage contingency request for all rate cases (I was unable to find an estimate of TY equity for R74-1). As the table shows, the Postal Service is far better able to absorb the impacts of an adverse financial occurrence than it has been in the past. In fact, projected TYAR equity has been positive only in two cases since the R87-1 case: this case and R2005-1.

Table 2: Historical Contingency Requests and Test Year Equity

Case	Contingency Request	Contingency Value ($ millions)	TY Equity ($ millions)
R 74-1	1.2%	149.0	
R 76-1	4.0%	547.0	363
R 77-1	4.0%	125.7	98
R 80-1	3.0%	655.7	-1,620
R 84-1	3.5%	982.4	-415
R 87-1	3.5%	1307.1	180
R 90 -1	3.5%	1617.2	-256
R 94 -1	2.0%	1052.0	-5,456
R 97 -1	1.0%	605.5	-1,499
R 2000 - 1	2.5%	1680.0	-134
R 2001 -1	3.0%	2160.4	-2,995
R 2005-1	0.0%	0	5,687
R 2006-1	1%	767.0	2,266

Source: DMA-LR-1, Tab 8, Comparative Analysis of USPS Revenue Requirement Requests

On cross examination, USPS witness Loutsch first opined that cash rather than equity is a more important aspect of the Service's ability to withstand adverse outcomes that create the need for the contingency. *See* Tr. 2/208. However, he later conceded that cash is related to equity "…as the equity goes up likely your cash balances are available or you have more financial flexibility going forward." Tr. 2/212.

Moreover, even if cash is the correct measure of the Service's ability to cope with adverse outcomes, the Postal Service must be seen as able to cope easily with an adverse outcome since its projected cash balance at the end of the Test Year is $5.587 billion (disregarding the escrow balance and assuming a zero contingency in this case). *See* DMA-LR-1, Tab 8, Comparative Analysis of USPS Revenue Requirement Requests. This strong cash position is superior to the cash balance projected for R2005-1, $3.826 billion, when the Service requested no contingency. Further, this projected cash balance is over seven times the size of the contingency request.

Finally, the financial condition of the Postal Service is even better than what appears on its books for two reasons. First, real estate is carried on Postal Service books in accordance with generally accepted accounting principals so any appreciation in real estate values does not appear on the books. *See* DMA/USPS-T6-8, Tr. 2/115. *See also* Tr. 2/235. And while the Postal Service has not conducted any studies comparing book value to market value, (*see* DMA/USPS-T6-7,Tr. 2/114), real estate values have increased over the years and market values are certainly higher than book, even if the Service cannot quantify the amount.

Notwithstanding the fact that the Service has not performed a study, witness Loutsch provided the methodology for conducting one:

> "Although one may speculate regarding the likelihood that market value of Postal Service owned real estate exceeds book value, I have no specific information that would support that conclusion….The actual market value of a specific property cannot be known for certain until that property is sold." DMA/USPS-T6-8, Tr. 2/115.

Thus, according to witness Loutsch, if one had a data set showing market prices and book value, for all Postal Service property, one could determine the relationship between the two. Obviously, not all Postal Service properties have been sold, so it is not possible to perform the Loutsch test on all properties. However, for all properties that have been sold between FY 2001 and the first half of FY 2006, sales price and book value are reported. Tr. 2/170 - 181.

I analyzed the data and found, not surprisingly, that market values exceed book values for the properties that have been sold. *See* Table 3, below. In 207 of the 348 transactions over the 5½ year period, market price (net of fees) was higher than book value. See DMA-LR-1, Tab, Summary of Property Sales Data. Further, aggregate market values - $145.7 million – were about 75 percent higher than book values - $82.0 million. Note also that the ratio of market to book has been increasing. Finally, I know of no reason to assume that the properties sold are anything other than representative of the total population of Postal Service real estate with respect to their book and market values. If they are, then market value for the Service exceeds book value by a substantial amount.

Table 3: Book and Market Value of Real Estate Transactions

Fiscal Year	Number of Sales	Book Value ($millions)	Market Value Net of Fees ($millions)	Ratio of Market to Book
2001	90	17.3	18.6	1.1
2002	76	12.1	20.3	1.7
2003	58	26.4	48.3	1.8
2004	41	11.1	22.3	2.0
2005	52	11.2	25.7	2.3
2006-to-date	19	5.3	10.4	2.0
Total	337	83.4	145.7	1.7

Source:DMA-LR-1, Tab 1, Summary of Property Sales Data

Second, even if real estate is carried at book value, it appears that the Postal Service may recognize some of the appreciation value from it. In response to questions from Commissioner Goldway, witness Loutsch agreed that END will reduce the number of facilities. *See* Tr. 2/226, 230. He also agreed that the sale of these properties has not been factored into TYAR revenue estimates, although he did say that the Service did not expect a large impact in the Test Year. Tr. 2/230. Finally, he also confirmed that because buildings are depreciated, sale prices are likely to be substantially higher than book value. *See* Tr 2/226, 227. Thus, it is likely that revenue from real estate sales in the Test Year will be higher than estimated.[2]

With so much cash, so much equity, no Prior Year's Losses to recover, the prospect of more frequent price changes,[3] real estate worth more than its book value, and perhaps more revenue from real estate sales than is estimated in the Test Year, the Postal Service needs no contingency.

[2] As a concrete example, I have attached as Exhibit DMA-2 an August 31, 2006 story from the Argonaut, indicating that the Postal Service sold a facility on Jefferson Boulevard in the Del Rey area of California for a price in excess of $60 million.

[3] As the Postal Service itself notes in the Transformation Plan, "To bring more predictability and responsiveness to pricing, the Postal Service will move to annual price changes for commercial products."

EXHIBIT DMA-1

USPS ANNUAL TABLES

FY 2005 TFP

TABLE 13

June 5, 2006

Table 13

Millions of Hours by Occupation

Year	Postmasters	Supervisors	Clerks and Mailhandlers	City Carriers and Vehicle Drivers	Special Delivery Carriers
1963	79.3	53.4	486.1	316.3	10.2
1964	78.6	55.1	492.5	322.9	10.3
1965	77.9	56.9	500.8	331.9	10.8
1966	72.4	59.8	536.2	344.0	11.5
1967	70.6	64.2	573.6	360.4	11.9
1968	70.0	70.1	588.6	371.5	12.5
1969	69.2	73.4	598.0	379.3	12.8
1970	68.1	76.5	606.0	384.1	11.9
1971	68.3	77.3	596.3	384.6	11.1
1972	67.2	78.7	564.9	380.5	10.1
1973	66.7	72.8	542.8	373.7	9.1
1974	66.5	77.5	563.3	376.8	8.9
1975	62.1	80.3	563.5	361.3	8.4
1976	57.0	85.0	538.9	349.8	7.5
1977	55.8	83.5	530.4	346.3	6.5
1978	53.2	83.5	526.3	344.6	6.1
1979	54.7	82.1	539.4	354.9	5.6
1980	55.4	87.6	537.7	357.4	5.5
1981	55.8	89.8	531.9	360.9	5.5
1982	53.8	90.6	524.8	365.0	5.3
1983	53.8	92.2	531.9	371.8	5.3
1984	53.9	96.0	568.8	396.5	5.4
1985	54.4	90.2	592.7	412.5	5.6
1986	54.3	91.7	614.4	424.7	5.7
1987	54.6	95.4	636.4	437.1	5.9
1988	54.9	97.5	651.3	450.4	5.8
1989	54.7	99.2	650.5	451.3	5.9
1990	54.5	95.2	640.8	452.3	5.7
1991	54.9	97.2	639.4	451.0	5.2
1992	55.0	96.4	623.2	450.9	4.9
1993	55.0	80.7	642.0	464.9	4.7
1994	55.8	74.7	663.9	477.9	4.7
1995	56.5	78.8	677.1	481.4	4.7
1996	56.4	80.5	691.3	479.3	4.5
1997	56.4	82.8	704.0	477.6	4.3
1998	56.5	84.9	708.0	482.8	3.0
1999	56.2	86.8	706.5	488.6	
2000	56.4	86.2	692.2	491.6	
2001	55.7	84.7	665.0	486.1	
2002	55.7	82.4	611.2	467.9	
2003	55.8	80.7	574.4	460.6	
2004	56.1	77.9	556.2	456.0	
2005	56.5	78.5	555.9	459.6	

Table 13 (continued)

Millions of Hours by Occupation

Year	Rural Carriers	Maintenance Service	Vehicle Service	PATs*	Other Personnel	Total
1963	77.3	34.1	8.1		16.8	1081.6
1964	76.5	34.5	8.0		16.7	1095.1
1965	76.5	34.9	8.3		16.4	1114.6
1966	76.4	35.8	8.6		16.3	1160.9
1967	76.6	37.5	9.0		16.8	1220.6
1968	76.6	40.2	9.8		17.9	1257.2
1969	76.8	43.1	10.5		18.7	1281.8
1970	77.2	44.6	11.0		19.5	1298.9
1971	78.3	46.8	11.4		22.1	1296.3
1972	77.9	47.8	11.4		21.5	1260.0
1973	77.0	45.6	10.4		22.3	1220.4
1974	77.3	47.8	10.1		25.1	1253.4
1975	77.7	49.6	9.6		26.8	1239.3
1976	78.5	50.5	9.1		27.4	1203.7
1977	78.5	51.4	8.9		27.3	1188.6
1978	80.6	51.3	8.8		24.3	1178.6
1979	82.6	52.2	8.8		25.1	1205.3
1980	84.7	52.6	8.8		26.0	1215.8
1981	86.5	54.2	8.9		27.3	1220.8
1982	82.3	56.2	8.8		27.1	1213.8
1983	84.6	58.4	8.8		26.9	1233.7
1984	87.0	60.4	9.0		26.8	1303.7
1985	91.7	60.8	9.2	13.5	26.8	1357.4
1986	96.0	62.1	9.5	13.4	25.7	1397.5
1987	99.8	63.6	9.7	17.6	24.6	1444.8
1988	106.2	66.6	9.9	18.6	25.2	1486.4
1989	109.2	68.3	10.0	18.3	25.3	1492.7
1990	113.6	67.9	9.8	17.3	25.4	1482.6
1991	117.3	70.2	9.7	17.2	26.0	1488.0
1992	120.7	72.0	9.6	18.2	26.9	1477.7
1993	124.5	71.5	9.1	17.1	23.3	1492.8
1994	132.0	73.3	9.4	19.4	23.3	1534.6
1995	139.3	75.8	9.7	19.9	23.7	1566.9
1996	146.0	77.8	10.0	20.2	24.5	1590.6
1997	149.9	79.3	10.7	20.6	25.3	1610.8
1998	156.8	81.1	10.8	21.2	25.7	1630.7
1999	162.8	82.6	10.8	21.0	26.1	1641.4
2000	170.5	83.7	10.8	19.1	25.5	1636.1
2001	173.4	83.7	10.8	18.1	24.4	1601.9
2002	171.1	82.8	10.8	18.0	25.5	1525.3
2003	168.1	82.3	11.1	18.3	22.5	1473.8
2004	172.3	81.4	11.1	18.2	23.2	1452.3
2005	180.1	80.9	11.1	18.5	22.1	1463.3

* Prior to 1985, Professional, Administrative, and Technical personnel are included with Supervisors.

EXHIBIT DMA-2

Top Stories

Del Rey: Home Depot acquires Postal Service site on Jefferson Blvd.

BY VINCE ECHAVARIA

The Home Depot, Inc. has purchased the former U.S. Postal Service Marina Processing and Distribution Center property on Jefferson Boulevard in the Del Rey area, a 20-acre site across Alla Road from an existing Home Depot store.

The property, at 13031 Jefferson Blvd., was purchased for a price in excess of $60 million, according to the real estate firm CB Richard Ellis, but some reports indicated that The Home Depot paid about $75 million.

Escrow closed on the former Postal Service site Tuesday, August 15th.

During the "highly competitive bidding process," offers were received from various home improvement retailers, office and industrial developers and multi-family builders, according to CB Richard Ellis — the firm selected to receive bids on the property.

In the end, Home Depot was selected as the buyer over 40 initial bidders and a final group of about eight, said Blake Mirkin, a senior vice president for CB Richard Ellis.

The transaction occurred nearly a year after the Postal Service put its Marina Center property up for sale in mid September.

The Postal Service had closed the facility, which is near Playa Vista, in July of last year to consolidate operations into a larger processing center in South Los Angeles.

Home Depot spokeswoman Kathryn Gallagher did not specify why the company wanted to buy the much larger 20-acre site across the street from a current Home Depot store, but said only that the company was interested in the prime location.

"The Home Depot is always looking for good sites, especially in thriving communities like Marina del Rey and throughout Los Angeles," Gallagher said.

Mirkin added that he believed the location of the site had an influence on The Home Depot wanting to purchase the property. The company saw a "huge potential" in controlling the site and was willing to pay a premium price, CB Richard Ellis officials said.

"I believe they felt it was a strategic location for them to control their destiny as it relates to any potential growth or expansion," Mirkin said of the purchase. "It enabled them to control that and it was a wise acquisition."

The Home Depot is currently expecting to lease the former Postal Service facility for about three to five years to a long-term temporary tenant, such as a distribution or retail-type tenant, to use the facility "similarly to what it is used for now," Gallagher said.

Company officials are still unsure about their plans for the 20-acre site, but they will use the time when the property is being leased out to determine what their project will be, such as a Home Depot store or another Home Depot concept, she said.

"We will work closely with the city in determining usage and working through all approvals," Gallagher said.

Although the future usage of the site has not been determined, Postal Service spokesman Larry Dozier said a retail postal presence will remain on the property, which currently contains the Alla Vista Post Office.

"It has been one of our goals all along to keep a retail presence there," Dozier said.

The news last year that the property would be sold sparked the interest of a diverse group of potential buyers, including the Del Rey Park Task Force, composed of community members seeking park space, and local environmentalists, but neither submitted bids.

Mark Redick, a Del Rey Neighborhood Council and Del Rey Park Task Force member, said he preferred that a "big-box retailer" became the new owner instead of a residential developer.

"I would much rather see that type of business go in there than 500 condos," Redick said.

With a new project coming to the area, community members will be concerned primarily about increased traffic on the already busy Jefferson Boulevard, as well as potential effects from future demolition, Redick said.

Del Rey community members plan to work with Home Depot officials in the effort to get a portion of the 20-acre site dedicated for active open space, he said.

"We need to work with Home Depot and see what it is they want to do," Redick said. "By working together we will try to come up with something mutually beneficial."