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March 9. 2007

POSTAL REGULATORY COMMISSION
901 NEW YORK AVE. NW, STE 200
WASHINGTON, D. C. 20268

Gentlemen:

RE: Docket No. RM2007-1

Per your "interested persons" invitation, I am commenting regarding how best the Commission can fulfill the responsibilities assigned it by the Postal Accountability and Enhancement Act regarding establishing a modern system for regulating rates and classes for market dominant postal products.

I am the principal of Jon Mulford Associates, a management consulting firm specializing in Postal and Fulfillment affairs. I've been involved in Direct Marketing for over 40 years, have held leadership positions in the Washington, D. C. mailing community, and have testified several times regarding postal issues before the PRC and Congressional Committees. Comments are strictly my own and do not reflect the views of any current or former client.

Comments will for the most part be keyed to specific paragraphs in the Commission's Order #2, shown in bold italics.

I.A.2 &.3: CPI limitations for percentage changes in rates

The CPI limitation is, simply, untenable: it is incompatible with objective ***I.B.5, "to assure adequate revenues, including retained earnings, to maintain financial stability."*** PAEA implicitly assumes that financial health can be maintained while keeping periodic rate increases within an unadjusted CPI for all urban consumers. That assumption disregards visible cost pressures in excess of the CPI, ranging from adding approximately 1.7 million new delivery points every year, to employee health care cost increases that routinely exceed the CPI.

On the revenue side, serious questions exist as to whether First class mail volume may permanently be declining, thereby requiring rate increases greater than the CPI to keep revenue, and especially the concomitant 1C contribution to institutional costs, at desired levels.

Given the cost and revenue pressures, can USPS stay within the CPI, anyway? Yes, it can, in the short term, but only if it adheres to policies that ultimately are unsustainable, notably its remarkable string of productivity improvements. USPS is running out of major automation projects: the massive Flats Sequencing machine project is likely the last large scale opportunity to cut labor content via automation.

USPS has other methods to cut costs, ranging from outsourcing to cutting service. For instance, in 2003 USPS stopped limiting itself only to "sparsely populated" areas when letting Highway Contract routes. In a relatively (so far) benign change, USPS has cut service by removing mail boxes from street corners.

At roughly 80% of total USPS costs, labor compensation/benefits provides the greatest potential for saving money. But PAEA imposes no restrictions on union negotiations, nor does it tie the hands of arbitrators used in last – ditch binding compensation arbitration.

Hence a confluence of both revenue and cost factors will sooner or later make adhering to the CPI cap unlikely if not impossible without significant service cutbacks.

I.A.5: establish procedures to allow rate adjustments in excess of the annual limitation on an expedited basis due to either extraordinary or exceptional circumstances...

Rate adjustments in excess of the annual limitation won't need "exceptional circumstances" to be brought on: they'll be entirely predictable. In developing its system, the PRC should avoid narrow definitions of "extraordinary," and "exceptional."

I.C.5: ...the Commission shall take into account:.. the degree of preparation of mail for delivery into the postal system performed by the mailer and its effect upon reducing costs to the Postal Service;

Mail preparation pays off in the form of work - share discounts. USPS, if squeezed financially, may be tempted to shift more costs to mailers. The Commission should adopt the concept of "lowest combined cost" for mail preparation and rate - setting.

I.C.9: ...the importance of providing classifications with extremely high degrees of reliability and speed of delivery and of providing those that do not require high degrees of reliability and speed of delivery;

Not all classes of mail require a high speed of delivery, but all classes should have a high degree of reliability. Specifically, in the case of what used to be called "non – pref." mail (which includes Standard Mail) a key requirement is "predictability." Slower delivery is generally not a severe burden if the mailer can confidently predict when the piece will be delivered. The Commission should include the concept of "predictability" in its system for setting rates and maintaining service standards.

I.C.10: ...the desirability of special classifications ....including agreements between the Postal Service and postal users.

Negotiated Service Agreements require that the USPS benefits, financially. Over time, however, those benefits may change. The Commission should insure that periodic audits verify that claimed benefits persist through the duration of the NSA.

PAEA also requires that NSA's ***do not cause unreasonable harm to the marketplace.*** How will the Commission measure unreasonable harm? Were you to mention "NSA" to hundreds of mailers who might be eligible for discounts based on existing NSA's, most probably wouldn't know what you were talking about. Others might not have the resources to pursue an NSA. NSA's have the potential to be discriminatory and should be handled with kid gloves.

SUMMARY

PAEA has given the Commission an extraordinarily difficult mandate without giving it (or the Postal Service) enough tools. The Postal Service is required to "maintain and continue the development of postal services of the kind and quality adapted to the needs of the United States:" a statement that implies the continuation of universal service with no deterioration in delivery. But keeping rate increases within the CPI simply won't happen short of cutting service, or shifting more costs to mailers, or getting "givebacks" from employees, the latter unlikely given how labor contracts are negotiated. And a policy of borrowing money for operating expenses is a formula for financial suicide.

The USPS still has several cost cutting tricks in its bag, which may delay the day of reckoning. Volume trends after the (probably in) May, 2007 rate increase may indicate how close that day is.

PAEA has given the Commission extraordinary power to regulate the USPS. The Commission, in devising its system for setting rates and in other matters should at all costs avoid unnecessarily tying USPS management's hands as they attempt to cope with an impending financial crisis.

Sincerely,

Jonathan Mulford