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

ANNUAL COMPLIANCE REPORT : Docket No. ACR2009

**REPLY COMMENTS OF VALASSIS DIRECT MAIL, INC.
AND THE SATURATION MAILERS COALITION
CONCERNING POSTAL SERVICE FINANCIAL STABILITY**

(February 23, 2010)

Valassis Direct Mail, Inc. (Valassis) and the Saturation Mailers Coalition (SMC) hereby submit their reply comments concerning Postal Service financial stability.

I. OVERVIEW

As the Commission clearly recognizes, the critical issue facing the Postal Service, the Commission, mail users, and postal workers is the financial stability of the nation's postal system. The Postal Service's financial distress is due to several factors, including the decline in volumes due to inroads by competitive alternatives and the severe impact of the current recession. That, however, is not the most urgent problem. With the exception of the recession-induced decline last year, postal volumes and revenues over the last several years have been covering *current* postal costs. The Postal Service's financial hemorrhaging has instead been caused by the mammoth obligations imposed on it for the funding of retiree benefits – a staggering $7 billion dollars annually. These, in turn, are the result of legacy costs inequitably imposed on the Postal Service and its rate payers, resulting in a huge overfunding of retiree obligations that is a tax that has undermined the efficacy of the Postal Service as a communications medium and brought it to the brink of insolvency.

Correction of these overpayments by proper estimation of the obligations and crediting to the Postal Service would result in full funding of the obligations, eliminating the need for the burdensome PAEA payments into the retiree health fund. That, in turn, would enable the Postal Service to restore its financial health. Indeed, full credit for the overpayment would provide the Postal Service with the capital it desperately needs to rationalize and efficiently restructure its system to meet the nation's communications needs into the future.

What can be done to save the postal system and restore financial viability? More specifically, what can the Commission do through the Annual Compliance Review process? In the context of its *traditional* ACR role of determining the lawfulness of rates and service, the Commission's remedies are limited. The Commission cannot wave a wand to cure the current economic malaise, nor to restore postal volumes. Other actions, such as the notion of declaring current postal rates "unlawfully low" and ordering rate increases in the face of an already depressed and fragile market, would only make matters worse.[1]

However, the Commission does have a crucial role and responsibility under the statute that it can and should exercise: to thoroughly review the issue of the overfunding of the Postal Service's pension and retiree health obligations, as discussed

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1 We share Time Warner's concerns about the propriety of such an action. But even if the Commission possessed the requisite authority, exercising it to raise rates – in essence, overruling the Postal Service's considered managerial judgment that this is the worst time to be raising rates – would be foolhardy. It is in trying economic times like these, where a company's customers are themselves forced to seek ways to cut costs and explore alternatives, that the need for managerial pricing flexibility – including, particularly, discretion *not* to raise prices in the face of depressed demand – is most acute.

in the initial comments of the National Postal Mail Handlers Union (NPMHU) and elaborated upon herein. The Commission should then exercise its responsibility under section 701(a) of the PAEA to:

- inform Congress of the precarious status of the postal system;
- present its assessment of the rationality and impact of these obligations;
- make recommendations for legislative reform to correct the overfunding in order to maintain the postal system as a vital national communications medium; and
- explain the dire consequences of inaction.

Now is the time for the Commission, pursuant to its responsibilities under the PAEA, to take the initiative to focus attention on this critical issue and pursue corrective action.

II. OVERFUNDING OF PENSION AND RETIREE HEALTH BENEFITS IS THE GREATEST IMPEDIMENT TO POSTAL SERVICE FINANCIAL STABILITY.

In its initial comments filed on February 5, 2010, the National Postal Mail Handlers Union (NPMHU) states that:

> "… the most significant financial challenge facing the Postal Service is the need to correct the calculation and scheduling of mandated payments that are currently required of the Postal Service, both to the USPS Retiree Health Benefit Fund (PSRHBF) and to the Civil Service Retirement System (CSRS)." NPMHU Comments at 1.

We agree. While there are many facets to achieving financial stability, the greatest obstacle is the onerous and unjustified burden of these pension and retiree health obligations, which together are bleeding the Postal Service of more than $7 billion annually.[2]

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[2] Under the prefunding schedule dictated in the PAEA, the Postal Service must pay $5.5 billion into the Retiree Health Benefits Fund on September 30th. Even worse, under an amendment inserted late in the legislative process, the Postal Service must

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The Postal Service's Office of Inspector General (OIG) and the Commission have previously addressed the excessive annual postal payments for the retiree health obligation due to faulty assumptions in estimating the liability. Our reply comments focus on the overfunding of the CSRS pension obligation which, as NPMHU notes, is described and quantified in great detail in a more recent comprehensive report by the OIG: "The Postal Service's Share of CSRS Pension Responsibility," January 20, 2010 (the OIG Report).[3]

A. <u>The Recent OIG Report Exposes The Huge And Inequitable Overfunding of Pension Obligations Which, If Corrected And Properly Credited, Would Fully Fund The Postal Service's Retiree Health Prefunding Obligation</u>.

The OIG Report and its underlying analysis by the Hay Group, issued just one month ago, demonstrate that the Postal Service has been grossly overcharged for its share of pension obligations. As summarized in the Inspector General's cover letter:

> "[T]he current system of funding the Postal Service's Civil Service Retirement System pension responsibility is inequitable and *has resulted in the Postal Service overpaying $75 billion to the pension fund*. If this amount were returned to the Postal Service, it would create a pension surplus that could be transferred to the Postal Service's health benefits fund. The transferred amount would fully

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also pay current retiree health premiums out of its own pocket, rather than from the Fund as originally proposed, adding another $2 billion-plus to its mandated retiree health outlays. *Compare* PAEA section 803(a)(1)(A), amending section 8906(g)(2)(A) of Title 5, with the earlier Senate bill accompanying Senate Report S. 2468, August 25, 2004.

3 This report, the latest in a series of OIG reports that address critical issues concerning the Postal Service's financial relationship with and obligations to the federal government, is available on the web at: http://www.uspsoig.gov/foia_files/RARC-WP-10-001.pdf. *See, also*, the OIG reports on "Federal Budget Treatment of the Postal Service," August 27, 2009; and "Estimates of Postal Service Liability for Retiree Health Care Benefits," July 22, 2009.

> meet all of the Postal Service's accrued retiree health care liabilities and eliminate the need for the required annual payments of more than $5 billion. Also, the health benefits fund could immediately start meeting its intended purpose — paying the annual payment for current retirees. This payment was $2 billion in 2009." (emphasis added).

This $75 billion overfunding stems from a skewed methodology employed by the Office of Personnel Management (OPM) for calculating the federal government's share of the pension liability for postal employees who commenced employment with the old Post Office Department (POD) prior to creation of the United States Postal Service in 1971. At the time of passage of the Postal Reorganization Act (PRA) that created the USPS, it was expected that the pension obligation due to POD employees who continued with the new USPS would be equitably shared between the USPS and the federal government. CSRS pension benefits are based on an employee's average "high-three" years of salary, which in almost all cases occur near or at the end of the employee's tenure. This alone, as the OIG Report points out, suggests that the appropriate benchmark for allocating responsibility is the proportion of the employee's "years of service" between the old POD and the new USPS.

In contrast, OPM's methodology calculates the federal government's share based on the employee's *1971* salary – as though the employee never thereafter received any increases in salary – rather than a more rational "years-of-service" allocation. The OIG Report summary (at p. 2) highlights the inequity of this approach:

- Every time postal employees receive a pay increase, their CSRS benefits, including any earned at the Post Office Department, grow in value. The Postal Service [under OPM's methodology] must pay for this increase not only for post-1971 service but also for the years of service before 1971. An allocation methodology that assumes employees will receive no pay increases — not even to offset inflation — is not reasonable.

- The current methodology used to allocate CSRS obligations for employees with service prior to July 1, 1971, is not based on years of

> service and is inequitable to the Postal Service. For example, Hay Group shows how the Postal Service could be responsible for 70 percent of the pension of an employee who worked only 50 percent of his or her career for the Postal Service.

As discussed in section B below, OPM's methodology initially was mandated by an ill-conceived law enacted in 1974 that disowned the federal government's responsibility for the impact of USPS pay increases on the pension liability of pre-1971 hires. But as discussed in section C below, that law was *repealed* in 2003 by P.L. 108-18, which replaced the language of the old law with a mandate for a new dynamic-funding methodology based on sound accounting and actuarial principles. Yet despite that repeal, OPM has continued to rely on that old methodology. Its approach, now devoid of the force of law, is even more manifestly devoid of merit.

B. <u>The Stated Rationale For Expanding The Postal Service's Share Of The CSRS Pension Obligation In Public Law 93-349 Is Inconsistent With The Requirements And Limitations Congress Imposed On The Postal Service In The Postal Reorganization Act</u>.

In 1974 – three years after creation of the Postal Service – Congress enacted Public Law 93-349 as a device to limit the federal government's responsibility for the pension liability of employees who began service with the old POD prior to 1971. This law amended section 8348 of Title 5, governing Postal Service payments to the Civil Service Retirement Fund, by adding a new subsection (h)(1) which required that:

> "the United States Postal Service shall be liable for that portion of any estimated increase in the unfunded liability of the Fund which is attributable to any benefits payable from the Fund to active and retired Postal Service officers and employees, and to their survivors, *when the increase results from an employee-management agreement under title 39, or any administrative action by the Postal Service taken pursuant to law, which authorizes increases in pay on which benefits are computed*." (emphasis added).

Congress's rationale for this provision was that, because of the passage of the Postal Reorganization Act,

> "the Congress *now has no control – no oversight whatsoever* – with respect to the pay machinery in the Postal Service. Since each future pay raise, negotiated or otherwise granted to employees in the Postal Service, will result in a specific unfunded liability and a new drain on the Retirement Fund, the cost of this liability should properly and equitably be borne by the Postal Service." House Report 93-120, April 11, 1973, at 4 (emphasis added).

This rationale, however, is contradicted by the very nature of the requirements and restrictions Congress imposed on the Postal Service in the PRA. In truth, although Congress gave up *direct* control to set postal wages itself, it imposed on the new Postal Service a number of policies, constraints, and mechanisms in the PRA that would *inevitably lead to wage increases in the future*. Yet by then enacting P.L. 93-349, Congress effectively evaded responsibility for the impact of those wage increases on the Postal Service's pension liability for employees on the payroll as of the effective date of the PRA. These aspects are described below.

1. Mandatory Coverage Of USPS Employees In The CSRS Pension System.

By section 1005(d) of the PRA, Congress required that all Postal Service officers and employees be covered by the federal civil service retirement program. The Postal Service was forbidden from setting up its own retirement program. Moreover, the features and benefits of the mandatory CSRS program – including eligibility and vesting rules, contribution levels, pension benefit calculations and levels, and every other aspect of the CSRS – are set by Congress. The Postal Service is powerless to alter any aspect. Indeed, pension benefits cannot even be negotiated through the collective bargaining process. They are off the table, fixed exclusively by Congress.

Congress, of course, had reasons for imposing the federal retirement program on the USPS in 1971 as part of the overall scheme of the PRA. In doing so, however, Congress deprived the Postal Service of any flexibility to mitigate its pension liability through modifications to the program. Given that Congressionally-imposed constraint, Congress should have taken care that its funding requirements – and particularly the division between federal and USPS responsibility for pre-1971 hires – not jeopardize the Postal Service's financial viability.

2. Private-Sector Pay Comparability.

Congress did not give the Postal Service freedom to set employee compensation and benefits as it saw fit. Instead, in 39 U.S.C. section 1003(a), Congress required the Postal Service "to maintain compensation and benefits of all officers and employees on a standard of comparability to the compensation and benefits paid for comparable levels of work in the private sector of the economy." Clearly, Congress intended that, to the extent wages increased in the private sector over time, the Postal Service would increase its employee wages accordingly.

Having imposed this pay-comparability policy on the Postal Service in the PRA, Congress's action in later shifting the pension-financing burden for such wage increases from the federal government to the Postal Service is more akin to taxing the Postal Service for complying with Congressional policies.

3. Collective Bargaining and Binding Arbitration.

Congress in the PRA also imposed constraints on the USPS on the manner by which postal wages were set. In 39 U.S.C. sections 1203 and 1207, Congress required that the Postal Service honor existing labor agreements and that wages be set through collective bargaining and binding arbitration. Significantly, that bargaining and arbitration process excludes consideration of *any* changes to employee pension plans, which are established exclusively by Congress. Moreover, in considering compensation issues, both of the negotiating parties, as well as the arbitrators, must do so in the context of the Congressional policy directive of private-sector pay comparability as set forth in section 1003(a).

Here again, these Congressionally-imposed mechanisms and restrictions inevitably led to compensation increases that were as much (or more) the responsibility of Congress and the federal government as the Postal Service.

4. Federal Civil Service Pay Increases Since 1971.

Congress may not have had *direct* control over postal wages following enactment of the PRA, but it *did* have control over Federal Civil Service pay. The history of civil service pay increases since 1971 is instructive. According to a recent report to Congress prepared by the Congressional Research Service (CRS), federal civil service pay scales increased by 86.2% during the first decade following enactment of the PRA.[4] By the end of the second decade in 1991, civil service pay had increased by 176.4%.

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[4] CRS Report, "Federal Employees: Pay and Pension Increases Since 1969," January 20, 2010, at 8 (comparing 1981 federal civil service pay to 1971). This report is

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Over those same periods, CRS estimated that wages in the private sector (the benchmark Congress prescribed for postal compensation) increased by 111.8% through 1981, and by 235.8% through 1991. And, consumer prices (CPI-W) increased by 124.5% and 230.0% over those periods.

Given Congress's control over federal civil service pay, and its policy directive in the PRA that the Postal Service "maintain compensation and benefits" for postal employees comparable to those paid in the private sector, Congress clearly intended and expected that the Postal Service would increase wages in line with its policy. The claim in 1974 that Congress "now has no control" over postal wage increases ignores its own directives in the PRA. Indeed, the civil service pay raises that Congress enacted over time undoubtedly served as a "floor" in postal collective bargaining and arbitration deliberations, under the Congressional pay standard of private sector comparability.

This points to another absurdity of the purported rationale behind P.L. 93-349. Had the Postal Service not been created in 1971, those employees of the old POD would undoubtedly have continued to receive pay increases from Congress that, over time, would surely have tracked the pay increases that Congress granted to other federal civil service employees. Of particular note, over the three years between creation of the USPS and enactment of P.L. 93-349, Congress increased civil service pay by 22.5%, thereby increasing the federal government's liabilities for CSRS

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available on the web in pdf format at: http://assets.opencrs.com/rpts/94-971_20100120.pdf.

pensions.[5] Yet by virtue of P.L. 93-349, Congress abrogated *any* responsibility for the pension impact of USPS pay increases for former POD employees after 1971.[6]

5. Analogy to Private-Sector Spin-Offs.

In the private sector, if "Company A" spins off a division as an independent "Company B," the two can establish a variety of arrangements to account for the pension obligations of employees of B who were previously employed by A. Once independent, however, Company A cannot then:

- prohibit Company B from modifying or eliminating its pension plan either unilaterally or through collective bargaining as permitted by law (in the private sector, pension benefits are "on the negotiating table");
- impose "pay comparability" standards on Company B that will, over time, cause B's pension liability to grow; or
- dictate employment policies to Company B, such as rules on collective bargaining and binding arbitration.

In the private sector, there are market forces that provide an element of discipline and disincentive against overloading a spin-off company with excessive obligations that may impair its ability to thrive or survive, including the stock market and competitors. Furthermore, even if Company A overreaches by imposing an unaffordable pension liability burden on the spin-off company, Company B still has potential remedies to manage and control its obligation regardless of the pension accounting arrangement – including not just modifying or renegotiating its pension plan but also, in the worst case,

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5 See the CRS report cited above, January 8, 2008, at 8, comparing 1974 to 1971.

6 In addition, the OIG Report notes that "OPM uses a years-of-service methodology to allocate the cost of retiree *health care* premiums for retirees who split their careers between the Post Office Department and the Postal Service," and that applying the same years-of-service approach to pension obligations would align it with the treatment of health care obligations. OIG Report Summary at 2.

declaring bankruptcy and restructuring its debts and employee obligations, just as General Motors and Chrysler have recently done. Or, in the very worst case, Company B will simply go out of business.

By contrast, the Postal Service has been placed in an untenable and wholly unmanageable position by the skewed methodology originally dictated in P.L. 93-349, a methodology that *despite the repeal of that law in 2003* is still being employed by the OPM. As a result, the Postal Service – although effectively "bankrupt" in an ordinary business sense – must still shoulder massive inequitable obligations that it simply cannot afford to pay. It cannot alter its pension plan or benefits. It cannot declare bankruptcy, and then negotiate with its creditors to pay 20¢-on-the-dollar for its debt, because the Postal Service's creditor is the federal government, requiring an act of Congress to restructure.

In sum, Congress and OPM cannot equitably have it both ways: imposing policies and requirements on the Postal Service that have inevitably led to higher wages, but then refusing to accept a fair share of the resulting increased CSRS pension obligations for those USPS workers who commenced employment with the old pre-1971 Post Office Department.

C. With The Repeal of P.L. 93-349 In 2003, OPM's Continued Use Of The Old Methodology For Allocating The Pension Obligation Is Neither Required By Law Nor Equitable.

From 1974 until 2003, this onerous restriction in P.L. 93-349, codified in section 8348(h) of Title 5, was "the law of the land," and thus binding on the USPS and the Office of Personnel Management. In 2003, however, Congress enacted the Postal Civil Service Retirement System Funding Reform Act of 2003 (Public Law 108-18), which repealed P.L. 93-349 as part of its overhaul of the USPS pension funding system, replacing it in its entirety with a mandate for a dynamic-funding methodology based on sound accounting and actuarial principles.

Congress's intent to explicitly repeal the 1974 law (P.L. 93-349) is stated in Senate Report 108-35 that accompanied Senate Bill S. 380, the bill that was enacted as P.L. 108-18. As the Report explained (at page 6):

> "Paragraph (1) would *rewrite* section 8348(h). *It would repeal the existing provisions* requiring Postal Service payments for costs 'attributable to any benefits payable from the Fund ... when the increase results from an employee-management agreement ... or any administrative action by the Postal Service ... which authorizes increases in pay on which benefits are computed.' " (emphasis added).

This repealed provision is the *same* P.L. 93-349 that OPM continues to rely upon. The new language in P.L. 108-18 entirely replaced it, and was carried forward in the PAEA subject only to an amendment that relieved the USPS of the military pension obligation.

Despite the repeal of P.L. 93-349, OPM has continued to apply the same old methodology for allocating the share of responsibility for pre-1971 postal hires. In January 2004, the Postal Service requested that the Board of Actuaries of the Civil Service Retirement System reconsider OPM's methodology. Its request, however, was answered not by the Board of Actuaries, but by OPM. In its letter of September 16, 2004, to Postmaster General Potter, the OPM claimed:

> "Your request for reconsideration *fails to recognize the existence of P.L. 93-349* (July 12, 1974). Under this law the Postal Service was required to finance, through 30-year amortization payments, all increases in retirement liabilities that are attributable to salary increases granted by the Postal Service. The increases in liabilities were determined without regard to the amount of service the employees may have had before or after the Postal Service became independent on July 1, 1971." (emphasis added).

In truth, it was OPM who failed to recognize that P.L. 93-349 – the basis for its methodology – had been *repealed* well more than a year earlier.[7] Consequently, OPM's continued reliance on the old methodology can no longer be defended as being required by law. And most certainly, it cannot be defended on its merits, as we explained in section B above, and as further demonstrated in the OIG Report. Under any reasonable assessment that takes into account the requirements and constraints that Congress imposed on the new Postal Service in the Postal Reorganization Act, the OPM's methodology imposes a patently inequitable and unbearable burden on the Postal Service that threatens its solvency and ability to sustain an effective postal system for the American people into the future.

D. <u>The Commission Has The Authority And Responsibility To Assess The Rationality And Impact Of Overfunding On The Postal Service's Viability, And To Recommend Legislation To Fix The Problems</u>.

Under the PAEA, the Postal Regulatory Commission has a shared responsibility with the Postal Service in ensuring financial viability of the postal system. In addition, the Commission has a responsibility to (1) inform Congress on the status of the Postal Service's financial health, (2) educate it on key problems that impair the

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[7] OPM's letter also makes clear that the Board of Actuaries is not an independent agency but is instead an arm of OPM, deprived of authority to make an independent review. This lack of independence was emphasized in OPM's response (at p. 3) to Postmaster General Potter:

> "Although you addressed your January 26, 2004, letter to the Board of Actuaries, I am responding, on behalf of the Director of OPM, in order to avoid any possibility that a constitutionally suspect action be taken by the Board of Actuaries. … Because the Board of Actuaries is not composed of principal officers, a decision on a appeal under 5 U.S.C. § 8348(h)(4) and/or § 3 (b) of the Act must be subject to review by the Director of OPM or her designee under 5 U.S.C. § 1103(a)."

OPM's letter is available on the web at: http://www.usps.com/financials/_pdf/OPM-BOARDOFACTUARIESRESPONSE.pdf

Postal Service's ability to achieve its mission, (3) recommend changes that the Commission believes are necessary to rectify those problems, and (4) explain the likely consequences if those problems are not resolved.

In particular, under section 701(a) of the PAEA, the Commission is charged with the duty to, "*at least* every 5 years," submit a report to the President and Congress concerning (1) "the operation of amendments made by" the PAEA, and (2) "*recommendations for any legislation or other measures necessary to improve the effectiveness or efficiency of the postal laws of the United States*." (emphasis added). That mandate necessarily encompasses the authority to make legislative or other recommendations on an interim basis, particularly in circumstances such as this where the Postal Service's solvency is at risk, and where postponing action until the formal five-year report could leave the Postal Service in an even more dire financial condition at that time.

The overfunding of the Postal Service's pension and retiree health obligations must be at the top of the list for prompt legislative reform. In the olden days of robust demand for postal products, the impact of this overfunding was somewhat masked, as the costs could be spread over ever-growing mail volumes. That is no longer true. The simple fact is that neither the Postal Service nor mail users can afford these costs.

The impact of these excessive payments reaches even deeper. The resulting financial losses, widely reported in the press and within the mailing industry, have led to an impression that the Postal Service is "going down the drain," creating a lack of confidence among current and potential mailers. This, coupled with the specter of large rate increases that might be needed to cover these obligation-driven losses, has caused many to reconsider their business models and seek out other distribution channels, thus increasing the risk of a downward spiral. In addition, the cash drain caused by these payments has deprived the Postal Service of the capital that it needs to restructure its operations, thereby impairing its ability to improve efficiency and cut costs in the longer run.

In urging the Commission to take a proactive role on this issue before Congress, we would note two likely "pushbacks" that might be raised, but which in our view are irrelevant to the Commission's role in this process.

First, the requested relief is not a "bailout," but rather an adjustment to equitably credit the Postal Service for its overfunding of its pension and retiree health obligations.

Second, the Commission should assess the issue on its merits, *without regard* to federal budgetary concerns, laying out the funding approach that most equitably allocates the burden between the Postal Service and the federal government, and explaining the consequences to the postal system of inaction. Budgetary aspects, whether a concern that Congress will "never give the money" or worries about how relief will "score" for budgetary purposes, should not deter the Commission from presenting its view of the proper and equitable estimation of the Postal Service's pension and retiree health obligations. That is the Commission's responsibility to Congress under the PAEA. Ultimately, it will be up to Congress to decide the remedy and its impact on the budget.[8]

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8 Consideration of these issues and their impact on the Postal Service's viability is clearly within the broad oversight mandate that Congress has granted to the Commission under the PAEA. See, for example, PAEA section 802(c), concerning Commission review of OPM determinations as requested by the Postal Service.

Respectfully submitted,

/s/ __________________________

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