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May 21, 1998

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The Honorable Thomas J. Koerber
Secretary
Governors of the United States Postal Service
475 L'Enfant Plaza West, S.W.
Washington, DC 20260

Re: Docket No. R97-1, *Postal Rate and Fee Changes, 1997*

Dear Mr. Koerber:

The Alliance of Nonprofit Mailers ("ANM") respectfully submits its comments under 39 C.F.R. § 9.2 on the May 11 Opinion and Recommended Decision of the Postal Rate Commission. For the reasons set forth in ANM's post-hearing briefs to the Commission, adoption of the rates recommended by the Commission would violate 39 U.S.C. §§ 3621 *et seq.*[1]

Rather than repeat its arguments in those briefs, ANM incorporates them by reference. In these comments, ANM makes two additional points.

[1] Initial Brief of ANM (April 1, 1998); Joint Reply Brief of ANM, American Library Association and Coalition of Religious Press Associations on Revenue Requirement (April 10, 1998); Initial Brief of ANM, American Business Press, Coalition of Religious Press Associations, Dow Jones & Company, Inc., Magazine Publishers of America, National Newspaper Association, the McGraw-Hill Companies, Inc., and Time Warner Inc. (April 1, 1998); Reply Brief of ANM, American Business Press, Coalition of Religious Press Associations, Dow Jones & Company, Inc., Magazine Publishers of America, National Newspaper Association, the McGraw-Hill Companies, Inc., and Time Warner Inc. (April 10, 1998).

1. Revenue Requirement

The Postal Service's financial performance during the most recent accounting periods has continued to widen the gulf between the projected operating losses offered to justify rate increases, and the Service's actual operating results. At the end of the rate case, the Service asserted that it would suffer an operating loss of approximately $1.2 billion in Fiscal Year 1998 (the test year chosen by the Service) without a rate increase. Through the end of Accounting Period 6, actual operating results were over $1.2 billion in *surplus*. In Accounting Period 7, the Service, having projected an operating profit of only $ 62.8 million, enjoyed an operating surplus of $112.8 million. And it is common knowledge that Accounting Period 8 produced a surplus of about $68 million, far better than the projected loss of $47 million. *See* 37 Tr. 19910 (USPS financial plans). All told, the cumulative operating surplus through the first eight accounting periods now exceeds *$1.4 billion*.

Documents made public at the Board of Governors' meeting on May 5, 1998 also confirm that the Postal Service's expenditures on capital projects and management initiatives in FY 1998 are running far below the levels projected in the rate case. For example, according to a presentation by Michael Riley, the Service's Chief Financial officer and Senior Vice President, "Year-to-date Capital Commitments for Postal Quarter II were $633 million compared with a budget of $1.4 billion." *See* Attachment A, *infra*. It is no answer that these funds may ultimately be spent in FY 1999 or some later fiscal year. The Postal Service will also receive additional *revenues* in FY 1999 and later fiscal years. The purpose of a test year in a rate case is to establish an agreed-upon period for comparing revenues and costs. Deducting more than one year of expenses from one year of revenue is completely illegitimate.[2]

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[2] The Postal Service often aspires to be treated in more respects like a privately-owned business. A private business that reported its taxable income by deducting more than one year of expenses from a single year of income would find itself in trouble with the IRS.

Do the Governors really believe that the Postal Service, without a rate increase, would suffer losses in Accounting Periods 9 through the end of FY 1998 large enough to wipe out the $1.4 billion cumulative surplus, let alone drive the Service into a test year operating deficit of $1.2 billion? If so, the Governors owe the public a full and candid explanation of (1) how much the Governors now believe the Service would lose during the remaining accounting periods of FY 1998 if the existing rates were to remain in effect, and (2) the specific sources of those losses.[3] If not, then the rate changes recommended by the Commission violate 39 U.S.C. § 3621, and must be rejected. Section 3621 entitles the Postal Service to break-even earnings, not monopoly profits.

2. Misattribution of Commercial Mail Processing Costs to Standard (A) Nonprofit Mail

The Commission's May 11 decision recommended disproportionately high rate increases for nonprofit Standard (A) mail vs. commercial Standard (A) mail: 9.6 percent on average for the former vs. 1.2 percent for the latter. This discriminatory treatment cannot be excused by the vagaries of attributable costs or the dictates of the Revenue Forgone Reform Act of 1993. Rather, these disparities stem in large part from a misattribution of commercial mail processing costs by nonprofit mail.

As ANM noted in the proceedings below, the reported cost data for nonprofit mail are tainted with IOCS tallies for mail with nonprofit markings entered at commercial rates. In determining the total mail processing costs attributable to nonprofit mail, the costs of processing these pieces are attributed by the IOCS to

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[3] To the extent that the losses projected for the remaining accounting periods include expenditures on the Service's various capital spending projects and management initiatives, ANM specifically requests that the Governors explain how the depreciation or amortization rates applied to those expenditures to determine the amounts charged as expenses to FY 1998 have been properly matched with the periods over which the Service expects that it or mailers will receive benefits from those investments.

nonprofit mail. In determining *unit* attributable costs, however, these pieces are recorded by the R.W. as *commercial* mail.

In its Recommended Decision, the Commission found that this phenomenon overstated nonprofit attributable costs by an unknown amount. R97-1 Op. & Rec. Decis. ¶¶ 5613-15. The Commission also found it "unfortunate that the Service did not expend significant efforts to evaluate the matter until the Commission's final ruling on the issue directed it to do so" (*id.* at ¶ 5616). Had "the Postal Service produced the available data sooner, analysts may have been able to conduct a more meaningful analysis of the data, thereby better quantifying the extent of the misallocated nonprofit costs." *Id.* at ¶ 1020.

The remedy offered by the Commission—an arbitrary one percent adjustment of "total nonprofit attributable costs" (*id.* at ¶ 5616)—does not cure the problem, for its magnitude is considerably greater. As the proponent of rate changes, the Postal Service bore the burden of proof. 39 U.S.C. § 3624(a) (incorporating 5 U.S.C. § 556(d)). The actual level of attributable costs is a crucial element of any rate case—particular for nonprofit Standard (A) mail, for which Congress has dictated relatively low markups over attributable cost. If the record fails to quantify the extent of the cost misattribution, the remedy is not to guess at its extent, but to go back to the drawing board, perform a valid study, and measure the problem. ANM is willing to cooperate with the Postal Service in designing and performing a study. In the interim, however, rates so tainted with cross-subsidy cannot lawfully be implemented.

Respectfully submitted,

David M. Levy

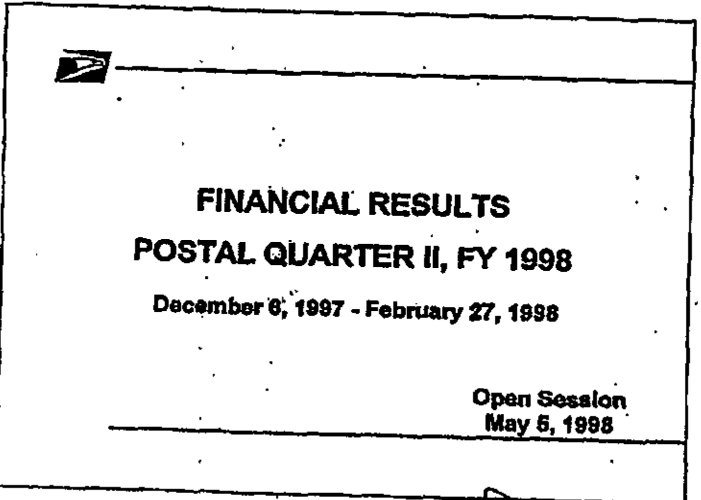
Counsel for Alliance of Nonprofit Mailers

cc: R97-1 service list

SLIDE 1 - TITLE

Thank you Mr. Chairman.

Let's start off with our profit and loss statement.



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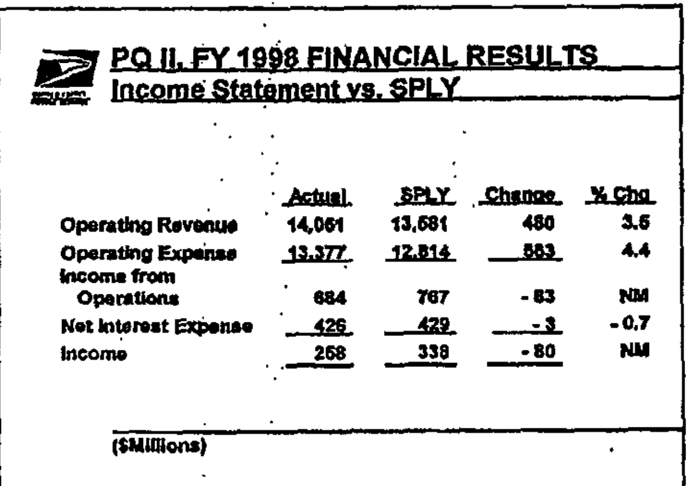
SLIDE 2 - INCOME STATEMENT vs. SPLY

In Quarter II the Postal Service had a net income of $258 million. This was $80 million below the same period last year and $160 million above budget. This decrease from last year's net income was a combination of revenue growth of 3.5 percent and operating expense growth of 4.4 percent.

I will go into more detail in each of these areas later.

Net Interest expense showed a slight decrease from last year. This is due to reduced borrowing.



PQ II, FY 1998 FINANCIAL RESULTS
Income Statement vs. SPLY

	Actual	SPLY	Change	% Chg
Operating Revenue	14,061	13,581	480	3.5
Operating Expense	13,377	12,814	563	4.4
Income from Operations	684	767	- 83	NM
Net Interest Expense	426	429	- 3	- 0.7
Income	258	338	- 80	NM

($Millions)

2

SLIDE 3 - INCOME STATEMENT vs. BUDGET

The Quarter II net income of $258 million exceeded budget by $160 million.

Operating revenue was 0.2 percent, or $25 million below budget; operating expense was 1.2 percent, or $158 million, less than budget.

Net interest expense was also better than budget.

PQ II, FY 1998 FINANCIAL RESULTS

Income Statement vs. Budget

	Actual	Budget	Var	% Var	% SPLY
Operating Revenue	14,061	14,086	[25]	[0.2]	3.5
Operating Expense	13,377	13,535	158	1.2	4.4
Income from Operations	684	551	133	NM	- 10.8
Net Interest Expense	426	453	27	6.0	- 0.7
Income	258	98	160	NM	NM

($Millions) [ ] = Unfavorable variance to Budget

SLIDE 4 - REVENUE by CLASS vs. SPLY

Quarter II revenues for all classes of mail, except periodicals, were above the same period last year. Total operating revenue growth of $479 million was primarily in Standard A mail, Priority Mail and First-Class Mail. While growth was relatively strong in these three categories, as you can see in the slide, First-Class remained at a low growth level. Revenue grew 3.5 percent over last year, with Priority Mail showing the greatest percentage growth.

Revenue from Priority Mail exceeded $1.0 billion for the first time in a normal quarter. This has only happened before during the UPS strike. We expect record revenues and volumes in Priority Mail this year.

International Mail and Other (primarily special services and retail products) revenues were substantially below budget.

Our strategic plan calls for defending First-Class; growing expedited products, surface parcels, Ad and International Mail; and, developing new product opportunities.

The new product opportunities that are reported to you each quarter are over SPLY and bottom line are making a positive contribution

Now let's look at Volume by class of mail.....

PQ II, FY 1998 FINANCIAL RESULTS

Revenue by Class vs. SPLY

	Actual	SPLY	Change	% Chg	% Budg
First-Class	8,127	8,013	114	1.4	0.1
Priority	1,039	902	137	15.3	8.7
Express	204	187	17	9.4	6.0
Periodicals	464	468	- 4	- 1.0	[3.4]
Standard A	2,973	2,813	160	5.7	[0.8]
Standard B	397	363	34	9.4	6.4
International	402	396	6	1.5	[10.1]
Other	455	440	15	3.5	[10.3]
Tot. Oper. Revenue	14,061	13,582	479	3.5	[0.2]

($Millions) [ ] = Unfavorable variance to Budget

SLIDE 5 - VOLUME by CLASS - SPLY

Volume compared to same period last year shows a 2.5 percent increase. Virtually all of the volume growth was in Standard A, which grew by 6.3 percent or 1.1 billion pieces. First-Class volume growth was almost flat at 0.2 percent. This is in contrast to the First-Class revenue growth of 1.4 percent. First-Class revenues are growing faster than volumes due to increases in weight per piece.

On a percentage basis, the volume growth leaders were Standard B mail, Priority Mail and parcel post. Express Mail and international mail also experienced volume growth.

Total volume was essentially equal to the budget plan. The shortfall in First-Class and periodical volume was offset by volume growth exceeding plan for other subclasses.

Now let's look at expenses..........

PQ II, FY 1998 FINANCIAL RESULTS
Volume by Class vs. SPLY

	Actual	SPLY	Change	% Chg	% Budg
First-Class	24,368	24,325	43	0.2	[0.5]
Priority	282	245	37	15.0	3.2
Express	16	14	1	8.3	4.3
Periodicals	2,341	2,389	-47	-2.0	[1.2]
Standard A	17,897	16,840	1,057	6.3	1.2
Std B - Parcel Post	68	58	10	16.5	12.9
Std B - Other	166	148	18	12.2	0.6
International	264	251	13	5.1	[9.6]
Other	95	100	-5	-4.6	11.4
Total Volume	45,497	44,370	1,127	2.5	[0.0]

Note: Other Volume includes Mailgrams, USPS Mail, and Free Mail for the Blind & Handicapped

($Millions) [ ] = Unfavorable variance to Budget

SLIDE 6 - MAJOR EXPENSE OVERVIEW

Total Expense was under budget 1.3 percent, but $649 million greater than last year. You will recall that Quarter 1 expenses were only 0.2 percent above last year. This more rapid expense growth in Quarter II relates to the timing of lump sum payments given to bargaining employees last year, and acceleration in expense growth this quarter related to programs.

Personnel compensation was $459 million over last year and 0.2 percent under budget.

Transportation was $87 million over last year and 5.2 percent over budget. Management's strong commitment to achieving service goals for First-Class and Priority Mail have driven the growth in transportation expenses.

Supplies and Services expense grew $159 over last year, an increase of 27.8 percent. Despite this strong growth over last year, supplies and services were 14.5 percent less than budgeted. Within Supplies and Services, contractual services in Headquarters directed programs and Corporatewide activities have the major underruns.

Other Non-personnel such as travel, vehicle maintenance and fuel and utilities were under last year by $143 million, mainly due to timing differences, but is also influenced by efforts to control expense growth

Interest Expense was also under last year and under budget.

Now let's look at our balance sheet.....

PQ II, FY 1998 FINANCIAL RESULTS
Major Expense Overview

	Actual	SPLY	Var	% SPLY	%Budg
Personnel Comp	10,539	10,080	459	4.6	0.2
Transportation	1,081	994	87	8.8	[5.2]
Supplies & Svcs	730	571	159	27.8	14.6
Othr Non-Persons	1,026	1,169	-143	-12.2	8.8
Interest Expense	432	445	-13	-2.9	7.3
Total Expense	13,808	13,259	649	4.1	1.3

($Millions) [ ] = Unfavorable variance to Budget

SLIDE 7 - BALANCE SHEETS - ASSETS

As we have more carefully managed our cash balances, current assets have declined since the beginning of the Fiscal Year from $1.5 billion to $0.9 billion. The negative amount shown for cash relates to checks that have been written by not posted to accounts.

Fixed assets have risen from 19.4 billion to 20.0 billion due to building and equipment purchases. The increase in the deferred retirement cost asset is offset by a corresponding increase in liability.

PQ II, FY 1998 FINANCIAL RESULTS
Balance Sheet - Assets

	February 27, 1998*	September 30, 1997
Assets		
Current Assets		
Cash & Cash Equiv.	0	394
Other Current Assets	1,087	1,069
Total Current Assets	1,087	1,463
Other Assets	373	372
Fixed Assets	20,048	18,374
Deferred Retire. Costs	33,543	31,929
TOTAL ASSETS	65,051	53,138

($Millions)

SLIDE 8 - BALANCE SHEETS - LIABILITIES

Current liabilities have increased more than $500 million since the beginning of the fiscal year. Total debt has declined from $5.9 billion to $3.4 billion due to seasonal patterns in our cash flow and utilization of our credit line.

As mentioned above the increase in the retirement benefit liability offsets an increase in the corresponding asset.

Workers' compensation liability has risen, reflecting the long term impact of current year injuries. And Other Liabilities have grown.

Due to the positive net income this year Cumulative Losses since Restructuring decreased. Net Capital Deficiency as of February 27, 1998 was $360 million, down $1 billion from the end of Fiscal Year 1997.

PQ II, FY 1998 FINANCIAL RESULTS
Balance Sheet - Liabilities

	February 27, 1998*	September 30, 1997
Liabilities		
Current Liab. less L/T Debt	11,703	11,187
Total Debt	3,390	5,872
Retirement Benefits	32,506	30,343
Workers' Compensation	6,028	4,749
Other Liabilities	2,784	2,347
TOTAL LIABILITIES	56,411	54,498
Equity		
Govt. Contributions	3,034	3,034
Cumulative Losses	-3,394	-4,394
Total Net Capital Deficiency	-360	-1,360
TOTAL LIABILITIES & EQUITY	65,051	53,138

($Millions)

SLIDE 9 - EMPLOYEE COMPLEMENT TREND

A complete complement report for Quarter II was recently mailed to you.

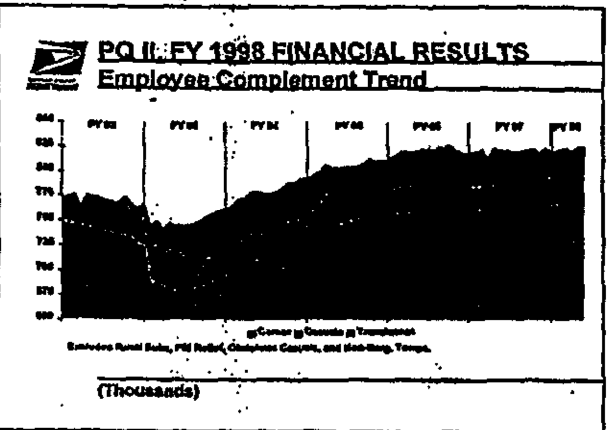
Highlighted on this slide is a summary of our complement trends by employee type since Fiscal Year 1992.

Total complement in Quarter II increased more than 600 employees over Quarter I. While Transitional employees decreased nearly 8,000, this decline was offset by increases of 3,900 Career and 4,700 Casual employees. Total complement at the end of Quarter II was 825,128 employees.

The decrease in the number of Transitional employees relates to the elimination of the Christmas Limited Duration Transition employees and our efforts to comply with the American Postal Workers Union (APWU) agreement to reduce the number on non-Remote Encoding Center Transitionals.

Career employees continue to increase as a result of extra workload and to manage overtime.

Looking at our productivity.....



SLIDE 10 - PRODUCTIVITY

This slide shows how Labor Factor Productivity and Total Factor Productivity or TFP have changed since 1992. The green bar represents Labor Factor Productivity and the red bar shows Total Factor Productivity.

As you may remember from the presentation Christensen Associates gave last year, TFP is the difference between workload increases and resource usage. Total Factor Productivity does not adjust for funds expended to improve service.

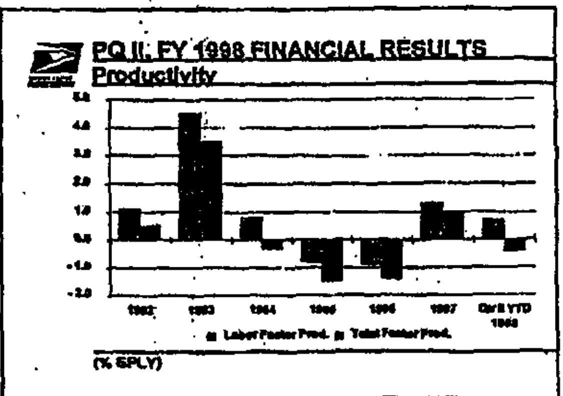
As this chart shows, through Quarter II, Labor Factor Productivity grew 0.7 percent, while Total Factor Productivity declined 0.4 percent. The decline in TFP was a caused by the increased consumtion of Materials and Capital, 6.9 and 4.1 percent, respectively.

The growth in Materials was the result of increases in Supplies & Services and Transportation. As you heard earlier, management's strong commitment to achieving service was the reason for the increase Transportation.

Our investment in infrastructure through the many programs we have begun or continued this year are the primary cause for the increase in Capital consumption.

In summary, our resource usage, which includes the large increases in Materials and Capital, was higher than our workload increase causing the decline in Total Factor Productivity for Quarter II, Year-to-Date.

Next I would like to show you the latest information for capital commitments......



SLIDE 11 - CAPITAL COMMITMENTS

Year-to-date Capital commitments for Postal Quarter II were $633 million compared to a budget of $1.4 billion. Retail equipment was over budget $3 million, with Point Of Service $14 million over budget for the quarter, as a result of a timing issues.

Significant underruns in Facilities were attributed to mail processing facilities, BMC expansion projects, and field projects that have not been committed.

The Vehicle underrun resulted from the delayed purchase of Carrier Route Vehicles. An award is now planned for late summer. The Tray Management System accounted for $105 million of the underrun in Fixed Mechanization.

Although Capital Commitments were considerably under the committed budget, cash outlays were $1.2 billion versus a budget of $1.5 billion, or $256 million under budget.

Now let's take a look at the Quarter II Year-to-Date Income statement ....

PQ II, FY 1998 FINANCIAL RESULTS
Capital Commitments

	Actual	Budget	Var	% Var
Facilities	339	549	-210	38.3
Auto/Mech Equip	116	428	-312	72.9
Support Equip	101	176	-75	42.8
Vehicles	43	250	-207	82.8
Retail Equipment	34	31	[3]	[9.7]
Total Commitments	633	1,434	-801	55.9

($Millions) [ ] = Unfavorable variance to Budget

Note: Totals may not sum due to rounding.

SLIDE 12 - INCOME STATEMENT QUARTER II YTD

Through Quarter II Net Income was $1 billion 234 million. This compares with $887 million last year. Although not shown, Net Income was $285 million better than budget.

Operating Revenue of $28 billion was $942 million or 3.4 percent over last year and 0.3 percent under budget. This growth was consistent with the growth in the economy.

Operating Expense of $26.2 billion grew $596 million or 2.3 percent. This increased from the Expense growth of 0.3 in Quarter I.

Net Interest Expense was even with last year due to reduction of interest expense on the debt which was mentioned earlier.

PQ II, FY 1998 FINANCIAL RESULTS
Income Statement - Quarter II YTD, FY 98

	Actual	SPLY	Change	% Chg	% Budg
Operating Revenue	28,275	27,333	942	3.4	[0.3]
Operating Expense	26,174	25,578	596	2.3	1.3
Income from Operations	2,101	1,755	346	NM	NM
Net Interest Expense	867	868	-1	-0.1	4.2
Income	1,234	887	347	NM	NM

($Millions) [ ] = Unfavorable variance to Budget

SLIDE 13 - INCOME STATEMENT AP 7

Accounting Period 7 which ended March 27, had a net income of $113 million. This compared to $202 million net income the same period last year and a budget of $63 million.

Operating Revenue of $4.7 billion was $113 million above last year or 2.5 percent but below budget by $33 million or 0.7 percent.

Operating Expense of $4.4 billion increased $202 million or 4.8 percent over last year and was under budget by 73 million or 1.6 percent.

Net Interest Expense was even with last year.

PQ II, FY 1998 FINANCIAL RESULTS
Income Statement - AP 7 , FY 98

	Actual	SPLY	Change	% Chg	% Budg
Operating Revenue	4,697	4,584	113	2.5	[0.7]
Operating Expense	4,444	4,242	202	4.8	1.6
Income from Operations	253	342	- 89	NM	NM
Net Interest Expense	140	140	0	0.0	6.7
Income	113	202	- 89	NM	NM

($Millions) [ ] = Unfavorable variance to Budget

SLIDE 14 - INCOME STATEMENT to SPLY

Through Accounting Period 7 Net Income was $1 billion 357 million. This compares with $1 billion 130 million last year and a budget of $1 billion.

Operating Revenue of $33 billion was $1 billion or 3.3 percent over last year. This growth was consistent with the growth in the economy. Although above last year, we were still under budget by $96 million.

Operating Expense of $30.7 billion was 2.7 percent over last year and $392 million or 1.3 percent better than budget.

Net Interest Expense was slightly under last year due to reduction of interest expense on the debt which was mentioned earlier.

Net Income of $1.4 billion was $227 million over last year and compares to a budgeted net income of $1 billion.

PQ II, FY 1998 FINANCIAL RESULTS
Income Statement - AP 7 YTD, FY 98

	Actual	SPLY	Change	% Chg	% Budg
Operating Revenue	33,003	31,962	1,041	3.3	[0.3]
Operating Expense	30,639	29,824	815	2.7	1.3
Income from Operations	2,364	2,138	226	NM	NM
Net Interest Expense	1,007	1,008	- 1	-0.1	4.6
Income	1,357	1,130	227	NM	NM

($Millions) [ ] = Unfavorable variance to Budget

SLIDE 15 - SUMMARY

This was our seventh straight accounting period of positive net income.

Net income was $258 million in Quarter II, significantly lower than the $976 million reported in Quarter I. This dramatic drop highlights the seasonality of our business. We usually make most of our money in Quarter I, a little money in Quarter 2 and 3, and lose money in the fourth quarter.

Revenue grew 3.4 percent this quarter, slightly less than the 3.5 percent growth reported in Quarter I.

Expenses climbed steadily this quarter and were 4.4 percent over last year. As I mentioned previously, this increase reflects accelerated spending for programs. Quarter I expenses were up only slightly, 0.3 percent, over last year.

And, volume growth continued strong.

This concludes my presentation.