

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

MAIL PROCESSING NETWORK
RATIONALIZATION SERVICE CHANGES, 2012

Docket No. N2012-1

INITIAL BRIEF OF THE
AMERICAN POSTAL WORKERS UNION, AFL-CIO,
(July 10, 2012)

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

**MAIL PROCESSING NETWORK
RATIONALIZATION SERVICE CHANGES, 2012**

Docket No. N2012-1

**INITIAL BRIEF OF THE
AMERICAN POSTAL WORKERS UNION, AFL-CIO,
(July 10, 2012)**

The American Postal Workers Union, AFL-CIO (APWU) hereby presents its initial brief in Docket No. N2012-1.

I. Introduction

A. Summary of Proceedings

On December 5, 2011, the United States Postal Service (Postal Service or USPS) filed a Request for An Advisory Opinion pursuant to Section 3661 of Title 39. It requests that the Postal Regulatory Commission (Commission or PRC) “issue expeditiously an advisory opinion concluding that the proposed Mail Processing Network Rationalization Service Changes conform to the policies of Title 39, United States Code.”¹ This Request was followed by publication in the Federal Register of an Advance Notice of Proposed Rulemaking on December 15, 2012. The Advance Notice provided details of the service standard changes proposed as part of the Postal Service Mail Processing Network Rationalization (MPNR or Network Rationalization) plan.

The Postal Service Request initiating this docket was accompanied by written testimony of thirteen witnesses and approximately 40 public and non-public library references. During the second half of April, the Postal Service filed supplemental

¹ Request of USPS for an Advisory Opinion on Changes in the Nature of Postal Services (Request) at 14-15 (December 5, 2011).

testimony updating the original testimony of five witnesses concerning revised cost savings estimates.² The Postal Service also filed approximately 90 additional library references during the course of the proceedings in this docket.

Participants were given the opportunity to file testimony as rebuttal to the Postal Service's presentation and on April 23, 2012, the APWU, along with the National Association of Letter Carriers (NALC), the National Newspaper Association (NNA), the National Postal Mail Handlers Union (NPMHU), and the Public Representative, filed rebuttal testimony from 15 witnesses. The testimonies of two consultants hired by the Commission to evaluate aspects of the Postal Service proposal were also filed.

The Postal Service's final service standard changes were published in the Federal Register on May 25, 2012. On June 12, 2012, APWU filed supplements to the testimony of two witnesses, Mr. Marc Schiller (APWU-ST-1) and Dr. Pierre Kacha (APWU-ST-2) addressing the changes contained in the final rules. On June 22, 2012, the Postal Service filed surrebuttal testimony of four witnesses addressing various aspects of the intervenors' presentations. The Presiding Officer closed the evidentiary record in this case on July 5, 2012.³

B. Overview of MPNR

The change in the nature of postal services at issue in this docket is the Postal Service's proposal "to revise the current service standards for First-Class Mail, Periodical, Package Services and Standard Mail."⁴ Specifically, the Postal Service proposes to

eliminate the expectation of overnight service for significant portions of First-Class Mail and Periodicals. In addition, the two-day delivery range would be modified to include 3-digit ZIP Code origin-destination pairs that are currently overnight, and the three-day delivery range also would be expanded.⁵

² (Bratta, USPS-ST-1; Martin, USPS-ST-2; Smith, USPS-ST-3; Bradley, USPS-T-4; and Neri, USPS-ST-5).

³ Presiding Officer's Ruling No. N2012-1/74 (July 5, 2012)

⁴ USPS Request at 1.

⁵ Id.

The Postal Service claims that degradations in services standards “would allow for a significant consolidation of the Postal Service’s processing and transportation networks. This would result in an infrastructure that better matches current and projected mail volumes and would result in significant cost savings.”⁶ In support of its planned service degradations the Postal Service claims that these changes are necessary to permit it to achieve significant mail processing consolidations, thereby reducing costs substantially.⁷

The Postal Service originally estimated that the MPNR proposal would produce \$2.6 billion in savings, minus \$0.5 billion in net contribution resulting from expected volume and revenue losses, resulting in an estimated net savings of \$2.1 billion.⁸ After the completion of the AMP studies, these estimates were revised downward to an estimated \$2.06 billion in cost savings.⁹

However, on May 25, 2012 the Postal Service published its final rule regarding service standard changes in the Federal Register. The final rule established phased implementation of MPNR, with two rounds of consolidation occurring in Phase 1 (between July 1, 2012 and 2013) and another round of consolidations in Phase 2 (planned for February 2014).¹⁰ During Phase 1, overnight delivery will be preserved for a significant volume of First-Class Mail, but Phase 2 will eliminate overnight delivery for all mail save for qualifying pre-sort mail.¹¹ The Postal Service provided no cost savings estimates for Phase 2 and provided only a high level estimate of Phase 1 savings. Inexplicably, the estimated savings produced for Phase 1 were calculated from the original cost estimates, even though those estimates had been revised.¹² The Postal Service contends that it will be able to save the these estimated savings, even though it will not achieve the productivity improvements from eliminating overnight delivery until Phase 2.

⁶ USPS-T-1 at 1

⁷ Id. at 10

⁸ See USPS-T-9 and USPS-T-12 for cost savings and revenue estimates respectively.

⁹ See USPS-ST-4 at 16.

¹⁰ Tr. 9/2713-2714.

¹¹ Tr. 9/2763.

¹² Tr. 9/2717.

II. Changes in the Nature of Postal Services Must Comply with Title 39

A. Legal Requirements

The Postal Accountability and Enhancement Act requires that the PRC issue an advisory opinion on the Postal Service's Mail Processing Network Rationalization proposal's compliance with the Act. Specifically, Section 3661(c) states:

The Commission shall not issue its opinion...until an opportunity for a hearing on the record under sections 556 and 557 of Title 5 has been accorded... . The opinion shall be in writing and shall include a certification by each Commissioner agreeing with the opinion that in his [or her] judgment the opinion **conforms to the policies established under this title.** [Emphasis added]¹³

Accordingly, the Postal Service is required to show in this docket that its MPNR proposal complies with the policies and requirements found in various sections of Title 39. Specifically, the Postal Service must demonstrate that MPNR complies with Section 101 of the Act which expresses the fundamental and enduring policy that

...The Postal Service shall have as its basic function the obligation to provide postal services to bind the Nation together through the personal, educational, literary, and business correspondence of the people. It shall provide prompt, reliable, and efficient services to all communities...

39 U.S.C. § 101(a); and

The Postal Service shall provide a maximum degree of effective and regular postal services to rural areas, communities, and small towns where post offices are not self-sustaining...

Id. at § 101(b). In addition, Section 101(e) Title 39 requires the Postal Service to "give the highest consideration to the requirement for the most expeditious collection, transportation, and delivery of important letter mail," while Section 101(f) requires that

In selecting the modes of transportation, the Postal Service shall give the highest consideration to the **prompt** and economical delivery of all mail. Modern methods of transporting mail by containerization and **programs designed to achieve overnight transportation to the destination of important letter mail to all parts of the Nation shall be a primary goal** of postal operations. [emphasis added]

¹³ 39 U.S.C. § 3661(c).

Additionally, Section 404 of the Act details a number of powers granted to the Postal Service. The specific powers granted to the Postal Service include in relevant part:

(a)(1) to provide for the collection, handling, transportation, delivery, forwarding, returning, and holding of mail, and for the disposition of undeliverable mail;

...

(b) 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 chapter 36. Postal rates and fees shall be reasonable and equitable and sufficient to enable the Postal Service, under best practices of 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.

(c) The Postal Service shall maintain one or more classes of mail for the transmission of letters sealed against inspection. The rate for each such class shall be uniform throughout the United States, its territories, and possessions. One such class shall provide for the most expeditious handling and transportation afforded mail matter by the Postal Service. No letter of such a class of domestic origin shall be opened except under authority of a search warrant authorized by law, or by an officer or employee of the Postal Service for the sole purpose of determining an address at which the letter can be delivered, or pursuant to the authorization of the addressee.

In exercising its authority under Title 39, Section 403 of the Act requires the Postal Service to balance the economies of postal operations with the public's access to essential postal services.¹⁴

¹⁴ 39 U.S.C. § 403 provides

(a) The Postal Service shall plan, develop, promote, and provide adequate and efficient postal services at fair and reasonable rates and fees. The Postal Service shall receive, transmit, and deliver throughout the United States, its territories and possessions, and, pursuant to arrangements entered into under sections 406 and 411 of this title, throughout the world, written and printed matter, parcels, and like materials and provide such other services incidental thereto as it finds appropriate to its functions and in the public interest. The Postal Service shall serve as nearly as practicable the entire population of the United States.

(b) It shall be the responsibility of the Postal Service—

Furthermore, the Postal Service has to comply with specific requirements related to the rates it is permitted to charge for postal services and the services provided. For example, Section 3622 limits the Postal Service's ability to increase rates by imposing a rate cap limitation. Similarly, Section 3622(e) limits the discounts given to mailers who perform workshare activities, requiring that those discounts not exceed the costs avoided by Postal Service as a result of the mailers' worksharing.

Finally, Title 39 also details the requirements when the Postal Service establishes or changes service standards. Under Section 3691

Such standards shall be designed to achieve the following objectives:

(1) In general.--Such standards shall be designed to achieve the following objectives:

(A) To enhance the value of postal services to both senders and recipients.

(B) To preserve regular and effective access to postal services in all communities, including those in rural areas or where post offices are not self-sustaining.

(C) To reasonably assure Postal Service customers delivery reliability, speed and frequency consistent with reasonable rates and best business practices.

The development of these standards must also take into account:

(1) the actual level of service that Postal Service customers receive under any service guidelines previously established by the Postal Service or service standards established under this section;

(1) to maintain an efficient system of collection, sorting, and delivery of the mail nationwide;

(2) to provide types of mail service to meet the needs of different categories of mail and mail users; and

(3) to establish and maintain postal facilities of such character and in such locations, that postal patrons throughout the Nation will, consistent with reasonable economies of postal operations, have ready access to essential postal services.

(c) In providing services and in establishing classifications, rates, and fees under this title, the Postal Service shall not, except as specifically authorized in this title, make any undue or unreasonable discrimination among users of the mails, nor shall it grant any undue or unreasonable preferences to any such user.

(2) the degree of customer satisfaction with Postal Service performance in the acceptance, processing and delivery of mail;

(3) the needs of Postal Service customers, including those with physical impairments;

(4) mail volume and revenues projected for future years;

...

All of these requirements taken together demonstrate that the Postal Service is not permitted to make changes to the services it provides without substantial justification. This necessitates a showing that the benefits of a change in service are properly weighed against the costs, including lost revenue and limited future opportunities. These requirements also suggest that the Postal Service must make significant attempts to retain the level of service provided before claiming that such changes are necessary.

B. Summary of APWU Argument

The Postal Service intends to eliminate overnight delivery for a significant portion of First Class Mail. The Postal Service contends that “[i]n order to achieve significant mail processing consolidation, and generate increased efficiencies in mail processing, a modification to current service standards is necessary.”¹⁵ However, the record in this case fails to demonstrate that the proposed changes to service standards are a necessary or desirable solution to the Postal Service’s present financial situation. The Postal Service admits, as it must, that any changes to market dominant service standards must be consistent with various policies of Title 39, including the fundamental postal policy to bind the nation together through correspondences of the people, found in Section 101.¹⁶ The Postal Service asserts throughout this docket that its future financial viability is at risk and as such, its Network Rationalization proposal is, under

¹⁵ Direct Testimony of David Williams on Behalf of USPS, USPS-T-1 at 10.

¹⁶ USPS Request at 5-7.

best business practices, a warranted response to severe financial circumstances which properly balances all of the policies and requirements of Title 39. The financial distress of the Postal Service is not in dispute.¹⁷ However, the Postal Service's contention that a reduction in service of the magnitude proposed is a responsible business decision, that will be effective at ensuring the future survival of the Postal Service has not be established in this docket. Instead, the record evidence in this case demonstrates that MPNR is a high risk plan developed without serious consideration of its compliance with the policies and requirements of Title 39, many of which would temper such rash plans. As noted, the Postal Service faces a daunting financial picture, and the law does grant the Postal Service some flexibility to determine an appropriate solution. However, the Postal Service is a quasi-governmental entity with an important public service mandate.

Accordingly, Section 3661 directs conformance with the policies of Title 39, thus requiring the Postal Service to demonstrate serious efforts to balance the interests of the public in postal services with the business needs of the Postal Service whenever it proposes to change the nature of its postal services. In the present case, the Postal Service's overarching premise appears to be that because MPNR is required for its survival the proposal necessarily complies with all the policies of Title 39.

However, as described more fully below, the Postal Service has failed to justify these service standard changes as an appropriate and necessary response to its financial situation. Specifically, the cost savings estimates presented in this case to justify the elimination of overnight delivery for the majority of First Class mail are overstated because the Postal Service has failed to separate which cost savings it could achieve without making any changes in its service standards from the cost savings that

¹⁷ The Postal Service's latest Form 10-Q filed with the Commission on May 10, 2012, shows that it had a year-to-date (through the end of March 2012) loss of \$875 million prior to accounting for the Postal Service Retiree Health Benefits Fund (PSRHBF) expense and the (non-cash) changes to the discount rate for its worker's compensation calculations. The PSRHBF accruals and the change to the worker's compensation assumptions resulted in an additional loss of \$5.6 billion. The (unaudited) May financials, filed with the Commission on June 26, 2012, show the Postal Service with a year-to-date (through May 2012) loss of \$737 million prior to accounting for the PSRHBF accruals and the changes to the worker's compensation assumptions. The PSRHBF accruals and changes to the worker's compensation assumptions result in an additional deficit of \$9.4 billion.

could be achieved only by degrading the service standards. Additionally, the Postal Service's estimated impact on revenue, volume and net contribution is understated and realistically, MPNR will cause a massive negative impact on the Postal Service. Finally, the claim that the service standard changes are necessary is further undermined by the fact that the Postal Service has failed to consider viable alternatives that would largely preserve service standards while still permitting the Postal Service to achieve substantial cost savings without endangering future revenue and business opportunities.

C. Recommendations

In order for the Postal Service to effectively demonstrate the impact of a change in the nature of postal services and to establish that the proposed change satisfies the policies and requirements of Title 39, USPS needs to establish accounting mechanisms that allow it to properly credit savings to the appropriate driver. For example, work hour savings that occur because mail volume falls should be credited to falling volumes of work and not to other initiatives such as consolidations. Post Implementation Reviews – used frequently in Postal Service presentations to assist in various costing – are notorious for measuring change from all causes between two points in time without crediting cost changes to their drivers which may include falling mail volumes and a dozen separate initiatives which effect costs. Everything gets credited to the consolidation.

In support of its network rationalization proposal at issue in this case, the Postal Service is including all the savings that might occur through consolidations and operational changes. Many of the consolidations could occur without changing service standards. Some transportation changes and savings might occur without the service standard changes. Those savings should be itemized separately. The consolidations and operational changes that can only occur if there is a degradation in service standards should be totaled separately and after deducting likely loss in contribution from lost mail volume – weighed against the degradation in service to determine the worth of this initiative (or any future network revisions).

USPS needs to move carefully and step-wise through consolidations. Before the next set of consolidations, it should detail the impacts on other products – particularly packages - and any remedial steps to assure performance with their associated costs.

The APWU contract was designed to achieve savings and productivity increases by having a more flexible workforce that could be scheduled to match workload. USPS analysis of productivity increases due to an elongated operating window uses rigid work rules for scheduling – more rigid than what was possible under previous CBAs and far more rigid than what is possible under the current CBA. Having launched Phase 1, the Postal Service has a laboratory in which it could test the assumptions and methods used in this case. For example, the Postal Service could study what productivity increase it can achieve from elongation of operating windows as compared with the old windows using new scheduling flexibility.

The Postal Service needs to provide the details, design, and costs of hubs that will be necessary as the network is changed. It should provide some mail entry and distribution capabilities at the hubs to provide quick delivery particularly for periodicals and certain package products. This is particularly critical for periodicals where the July 1, 2012 change in service standards will potentially degrade the service of a high percentage of periodicals volume and will degrade service further in 2014.

III. USPS Cost Savings Estimates Are Seriously Flawed and Overstated and Therefore Cannot Justify the Significant Reduction in Service Proposed

As noted above, the policies and requirements of Title 39 do not permit the Postal Service to make changes to the postal service without justification. In the instant case, the Postal Service justifies the severe reduction in service with estimates of costs that could be saved as a result of the operational changes that would be permitted as a result of the elimination of overnight delivery for First-Class Mail and Periodicals. The Postal Service presents essentially two calculations of cost savings – those calculated by USPS Witness Bradley and Smith and officially endorsed as the legitimate costs savings expected from MPNR; and the results of the AMP studies conducted pursuant to this proposal. For the reasons explained more fully below, both measures are seriously

flawed and overstate the estimated cost savings of MPNR. Therefore, the Postal Service has failed to demonstrate that the proposed network rationalization plan conforms to the policies of Title 39 as required by Section 3661.

A. The Cost Savings Presented by USPS Witnesses Bradley and Smith Are Seriously Flawed Resulting in an Overstated Estimate of Savings

In support of its Request the Postal Service provided a high-level estimate of the amount of cost savings that could be achieved from its proposed network rationalization plan. That estimate was produced by Dr. Bradley (USPS-T-10) and Mr. Smith (USPS-T-9) using a theoretical model that depended for its parameters on the rough estimates of productivity improvements, labor reductions, transportation changes and facilities, maintenance and equipment reductions resulting from Network Rationalization presented by USPS witnesses Neri (USPS-T-4), Martin (USPS-T-6) and Bratta (USPS-T-5). The calculation of these savings numbers involved three major steps: 1) the selection of a baseline against which to compare any changes; 2) a determination of the facilities that would be closed under network rationalization; and 3) the input of estimated parameters from the Postal Service's operations witnesses. As explained more fully below, there are major problems with each of these steps that invalidate the cost savings estimated to result from the Postal Service proposal. As a result, the Postal Service cannot rely on these costs savings to justify the substantial reduction in service it is proposing.

i. The Baseline Used to Estimate Cost Savings Is Unsound

In order to estimate the cost savings expected from MPNR an appropriate baseline must be identified. In the present case, the Postal Service chose to use as a baseline the cost of mail processing in FY2010. This baseline cost estimate is not representative of the current cost structure of mail processing for several significant reasons. First, mail volume has fallen since FY2010; therefore, the actual mail processing costs are already lower today than in FY2010.¹⁸ Second, the Postal Service had been actively

¹⁸ APWU-RT-1 at 12.

consolidating facilities using the AMP process between FY2010 and December 2011 when the Postal Service Request was filed. For those facilities the Postal Service decided to consolidate or close during this time period, it clearly had already been determined that those facilities could be consolidated without eliminating overnight delivery and otherwise maintaining the service standards then in effect (pre-July 1, 2012 service standards). It is illogical and disingenuous then to claim the savings resulting from the consolidation of these facilities as savings from Network Rationalization.

Third, the Postal Service did not incorporate any best practice or other productivity gains that had taken place since FY2010.¹⁹ It is undisputed that the Postal Service has achieved productivity gains since FY2010 that have reduced mail processing costs. These productivity gains were achieved prior to MPNR, so by not excluding these savings from the baseline, the Postal Service claims cost savings that are completely independent of network rationalization. Fourth, the Postal Service estimated cost savings did not incorporate any assumptions about the cost savings that could be achieved in the current mail processing environment through full implementation of the APWU 2010 National Agreement that had become effective in May 2011. Given that the Postmaster General has acknowledged that the APWU 2010 National Agreement could save the Postal Service \$3.8 billion at a minimum²⁰ and that the Postal Service has already begun utilizing the flexibility provided in the National Agreement, the baseline estimate should not include these savings which are unrelated to network rationalization and which will continue to be possible without network rationalization. In using the FY2010 baseline the Postal Service did not consider the likely change during the period of implementation of this plan that the changing composition of the workforce would have on the retirement-related components in the servicewide costs.

¹⁹ The Postal Service's FY2011 Total Factor Productivity filing shows that Postal Service TFP increased 2 percent in FY2010 and 1.3 percent in FY2011 (Table 52). Postal Service labor productivity increased 2.5 percent in FY2010 and 1.8 percent in FY2011 (Table 53). Annual TFP tables filed with the Commission on April 27, 2012.

²⁰ See Transcript of April 5, 2011 Hearing Before the House Committee on Oversight and Government Reform <http://oversight.house.gov/wp-content/uploads/2012/04/4-5-11-Full-Committee-Hearing-Transcript.pdf> p 48

In addition to these obvious and significant problems in using FY2010 as the baseline, the Postal Service also did not include important costs that would result from the implementation of this network rationalization plan that would tend to reduce the savings calculated from Network Rationalization. Those additional costs include the cost for hub transportation, transition and implementation costs, the additional costs that will be necessary to maintain current service for Priority Mail, Express Mail and package services where processing is often co-located and transportation shared with First Class products.

In short, the Postal Service failed to calculate a baseline that properly isolates only the savings due to Network Rationalization and excludes cost savings that have already been realized or are independent of the change in service standards. This would seem to be an absolutely necessary starting point for any organization prior to making a decision about degrading the service it is providing to its customers. Otherwise, it is not possible to weigh whether the benefit (cost savings) that can be gained from dramatically reducing service is worth the costs, including lost revenues, lost contribution to overhead, damage to relationship with customers and damage to the long term growth prospects of the Postal Service.

ii. The Determination of the Facilities that Would Be Closed Under Consolidation Is Not Accurate

In order to accurately estimate the cost savings to be expected from closing facilities as part of network rationalization, accurate identification of these facilities is required. However, the cost savings estimates provided by USPS witnesses Bradley and Smith in this case were not based on a set of facilities to be closed that was technically optimized for either costs or service. Instead, potential savings were estimated based on the flawed results of a high-level theoretical model that was never fully optimized presented by USPS witness Emily Rosenberg (USPS-T-3). Using a list of facilities that were open in FY2010, witness Rosenberg's model produced a set of facilities that might be consolidated as part of network rationalization. Not only did this have the obvious problem that it included facilities that the Postal had already determined could be consolidated without making any wholesale changes to the service standards, but

weaknesses in the model produced other questions about the result. For example, the model did not include transportation costs even though the plant-to-plant transportation costs would have been of great assistance in determining the best solution.²¹ Furthermore, Rosenberg's model was never an optimization model it was simply supposed to be a decision support tool²² but even the initial review by the field caused 61 sites activated by the model to be deactivated and 71 sites deactivated by the model were activated by the field review.²³ Once the Postal Service identified sites that had to remain active and the actual proposed operating windows were determined, Rosenberg's model should have been re-run to determine the most appropriate list of potential facilities that could go on the list to study for possible closure. This step was not done.

As noted by Public Representative witness Raghavan (PR-T-2), the assumption in Rosenberg's model of overly long processing windows produced a list of potential consolidations with too many facilities on it to actually achieve the mail processing activities presented in the Postal Service's proposal.²⁴ Ultimately, this meant that Dr. Bradley and Mr. Smith were handed a list of facilities to use in their theoretical cost savings that did not match the list of facilities that the Postal Service was planning to close. Therefore, the Postal Service has not provided an estimate of cost savings of the facilities that are actually expected to be closed. While the Commission directed an initial round of recalculations after the AMP analyses were completed, the new estimates provided by witnesses Bradley and Smith do not match the list of facilities that the Postal Service ultimately identified would be closed as part of its modified, two-phase plan announced May 17, 2012. Significantly, although the original list of facilities to be closed during network rationalization had been changed and the final list varied significantly from this initial list, the Postal Service continues to use the original \$2.6 billion estimate as the basis for determining its cost savings from Phase I of the plan. The Postal Service continued use of this estimate is illogical as the estimate was already determined

²¹ Raghavan, PR-T-2 at 14:17-19.

²² Tr. 4/914.

²³ Rosenberg USPS-T-3at 17:12-14.

²⁴ Raghavan ,PR-T-2 at 15:3-15

inaccurate²⁵ and the Postal Service had the results of AMP studies which could have been used to calculate the savings expected during Phase 1 and Phase 2 of the Postal Service's modified plan.

iii. The Parameters Used to Calculate the Cost Savings Estimates Are Supported by Incomplete Information or are Unsupported Altogether

The Postal Service's estimated cost savings are also not reliable because the set of assumptions that were used to underlie the initial estimates of Dr. Bradley and Mr. Smith are deeply flawed. Specifically, the parameters that those two costing witnesses used in their theoretical estimates were based on incomplete information, which often turned out to be wrong later on, or were not supported at all.²⁶ The operational assumptions were often incomplete. While some of these were adjusted for in the revised testimony submitted on April 30, 2012, other assumptions were left unchanged.

One of the main concerns is the estimated savings associated with the productivity improvements expected from this consolidation. The "savings" from those productivity improvements are 37 percent of Dr. Bradley's initial \$2.6 billion estimated total (Bradley Testimony USPS-T-10 at 41, Table 16) and constitute 47 percent of Dr. Bradley's supplemental savings estimate of \$2.1 billion, submitted on April 30, 2012 (Bradley Supplemental Testimony USPS-ST-4 at 16, Table 11). These productivity estimates are

²⁵ See Supplemental Testimony of Smith On Behalf of USPS, USPS-ST-4 at 16.

²⁶ For example, Ms. Martin's initial estimate of the plant-to-plant and plant-to-post office percent reductions in transportation capacity were radically revised in her April 16, 2012 and April 30, 2012 revisions. The original plant-to-plant capacity reduction of 24.7 percent (used in Table 12 of Dr. Bradley's initial report) were reduced to 12.8 percent. Ms. Martin's plant-to-post office capacity reduction of 13.7 percent (used in Table 15 of Dr. Bradley's original calculations) was reduced to 3.2 percent in the revised calculations. However, neither Ms. Martin nor Dr. Bradley were able to provide a reasoned explanation for the basic assumption used in estimating the savings of the plant-to-plant capacity reduction. That assumption is that a reduction in the number of trips can be directly translated to the same reduction in a cost based on cubic foot miles. Furthermore, as witness Matz opined, some of the 'savings' attributed to specific operational changes are unlikely to take place. One example is the elimination of the outgoing secondary sort. (PRCWIT-T-2 at 17 and 29). Witness Matz also questions the reliability of the assumptions underlying the maintenance savings. (PRCWIT-2 at 32).

highly speculative and there are several reasons to doubt that they represent a reasonable set of parameters to use for this process.

These productivity estimates were provided by USPS Witness Frank Neri in Figure 12 of his direct testimony. The only support for these productivity estimates in Mr. Neri's testimony is his statement that they were based on his "operational experience."²⁷ In response to POIR No. 1 Question 7, witness Neri provided library references USPS-LR-N2012-1/49 and 50. Those library references showed that Mr. Neri's methodology requires several simplifying assumptions. However, many of those assumptions are of dubious validity. First Mr. Neri aggregates data across the country by hour and for each shape. He uses the hour with the maximum volume to estimate maximum staffing and assumes that the Postal Service is staffing a full 8 hour shift around that time period. Mr. Neri next smooths the workload evenly over a 24 hour period and again determines a staffing level consistent with everyone working an 8 hour shift. From the difference in these two staffing estimates he calculates the productivity improvements that can be expected. However, as witness Kobe explains, Mr. Neri's basic assumption that everyone is working an eight hour day is incorrect.²⁸ The mail processing managers have and always have had much more flexibility than that.²⁹

Furthermore, the APWU 2010 National Contract creates new non-career postal support employees (PSEs) specifically for the purpose of providing a more flexible worker and to reduce the costs of mail processing.³⁰ Mr. Neri admits that he did not take into account the flexibilities these workers provide.³¹ Furthermore, witness Raghavan rightly points out that the workload cannot be smoothed over a 24 hour period, as is assumed by witness Neri, given the other assumptions the Postal Service has made about the processing windows under the Rationalization Plan. As Professor Raghavan states "the window over which the traffic is smoothed plays a critical role in this productivity improvement argument." (PR-T-2 at 31:3-4) His rough estimates reduce witness Neri's

²⁷ USPS-T-4 at 29:8-9.

²⁸ APWU-RT-1 at 18:16-17 (Revised May 3, 2012).

²⁹ Tr. 11/4293:22-4294:12 and 4308:23-4309:15.

³⁰ APWU-RT-1 at 17-18.

³¹ Tr. 5/2010.

average 28 percent productivity gain by over 75 percent and that is before any current workforce flexibility, such as the availability of PSEs, is taken into account. In short Professor Raghavan states “[m]y calculations would suggest [the productivity improvements] would be far lower than those implied by Figure 12 of witness Neri’s testimony (and calculated by witness Bradley.)” (PR-T-2 at 32:1-2)

Witness Weed also questioned the productivity estimates made by Mr. Neri. He states “[m]y review of how witness Neri determined an idle time percentage that led him to make an estimate of available potential productivity improvement leads me to conclude that his estimate has no factual support.” (PR-T-1 at 26:8-10) Witness Weed estimates the potential productivity improvement at 3-5 percent, albeit based on old data studies. (PR-T-1 at 26:12-13) Finally, Mr. Neri testified that in determining the staffing requirements for the AMP analyses undertaken for the facilities on the proposed consolidation list, the productivity changes for changing the operational windows were taken into account in determining the new staffing levels (along with mail volume changes and any other changes in operational practices that could be incorporated).³²

Of significance, in explaining the productivity changes that were used in making the staffing estimates for the AMPs, witness Williams does not depend on Mr. Neri’s Figure 12 adjustments but depends instead on calculations for each site based on Breakthrough Productivity Initiative (BPI) and adding an average 8 percent to each site’s current productivity numbers for Labor Distribution Codes (LDCs) 11-13.³³ Mr. Williams also testified that “if a gaining site had productivity in a specific operation which may have been more than 8 points lower than the losing site’s productivity for the same operation, the calculation returned a greater workhour cost for transferring this operation to the gaining site than is currently incurred at the losing site.”³⁴ This statement is in line with Mr. Weed’s testimony that the losing plant’s productivity for most MODS operations is generally higher than that of the gaining plant (PR-T-1 at 11:17-19) which means that to reach Dr. Bradley’s cost savings estimates a “dramatic improvement in all processing

³² Tr. 5/2053; see also USPS-T-4 at 30:16-17.

³³ Response of United States Postal Service Witness Williams to Question from Commissioner Taub During March 20, 2012 Oral Cross Examination, March 30, 2012, pp. 7-8.

³⁴ Id. at 7.

operations, both in volume and non-volume measured operations” would be required. (PR-T-1 at 9:7-10)

Witness Weed also explains how productivity gains are likely in some operations but not in others. For example, the cancellation operation involves adding volume to an existing operation that may more fully utilize the machines and labor assigned to it resulting in cost savings. (PR-T-1 at 10:4-7) On the other hand, the DPS operation, where the transfer of workload is effectively new work to the gaining facility, would not provide the same opportunity for productivity gains. When workload is added to the DPS operations it is because there are additional DPS sorts to produce the mail for the offices served by the losing plant. This is not a case of adding volume to the existing operation. Consequently, it is not clear that any productivity improvements can be expected in operations where the transfer of workload requires additional sortations to be accomplished. (PR-T-1 at 10: 9-14) As discussed in the next section, the AMP savings from the Postal Service’s analysis are nowhere near large enough to support the claim that the productivity improvements can generate savings of the size that Dr. Bradley has estimated.

Several of the witnesses indicated that \$2.6 billion estimate was a place holder until the savings analysis for the Area Mail Process (AMP) process was completed for the actual set of facilities that were to be closed. Witness Williams stated in his original testimony that Ms. Rosenberg’s list (as reviewed by the field officials) was “a list of plant-to-plant consolidation proposals that could be subjected to the rigorous USPS Handbook PO-408 Area Mail Process (AMP) analysis to validate the feasibility of implementing each consolidation proposal as part of a system wide network redesign.” (USPS-T-1 at 6:13-16) Mr. Neri testified that “[t]he Postal Service intends to use the AMP process as a vital decision-making tool in support of Mail Processing Network Rationalization Service Changes. This current process provides a time-tested and verified method of calculating savings associated with mail processing facility consolidation and/or closure.” (USPS-T-4 at 14:17-20) In her testimony Ms. Martin states “The facility-specific AMP process will ultimately determine the reductions that will occur as a result of the respective plant consolidations expected to be implemented. Although such savings would be mitigated

by an increase in transportation cost due to the fact that remaining plants must be connected to more Post Offices in the realigned network, I expect the Postal Service to realize plant-to-Post Office surface transportation cost savings when it rationalizes the processing network.” (USPS-T-6 at 12:23-13:7). Thus it seems clear that once the Postal Service calculated a cost savings estimate that it felt could justify the reduction in service, it stuck with it despite the fact that the underlying list of facilities being considered for closure was changing, despite the fact that assumptions were proven to be wrong or incomplete, and despite the fact that the AMP analysis, a “time-tested and verified method of calculating savings” produced a much smaller estimate of cost savings.

B. The Cost Savings Estimated by the AMP Studies Are Also Unreliable

i. AMPs Overstate Cost Savings

Witness Rosenberg’s modeling efforts generated a list of facilities. However, the modeling effort was only a high level starting point and even from the beginning area managers made major changes to it. The list of potential facilities that were going to be studied as presented in USPS-LR-N2012-1/6 was the actual start of the consolidation process for the Network Rationalization plan. These 252 facilities were those that were slated for further review. The original proposal identified 111 facilities into which these 252 facilities might be consolidated. This original list of 252 had 124 P&DCs or P&DFs, 3 L&DCs, 90 CSMPCs, 14 DDCs, 19 Annexes and 2 STCs. (See Table 1 attached). However, of that number 5 were simultaneously being considered as gaining facilities as well as losing facilities. Consequently, the Postal Service did not ever plan to consolidate all of these locations. Between the filing of the case and February 23, the date the results of the AMP analysis were announced, there were 11 additional facilities added to the list. Eight of those were P&DCs or P&DFs and 2 were additional CSMPCs.

The goal of the AMP analysis was to determine if it was actually feasible to move the mail volume (along with some of the machines and personnel) from the losing sites to the gaining sites while maintaining service standards. However, the service standards against which these consolidations were being gauged were not the current standards but rather those proposed in the preliminary notice on revising the service standards. These

proposed service standards added a day to First Class Service Standards and periodicals and also assumed a lengthening of the processing window. The change in the operational window determined how many machines were needed and how many personnel were needed to process the mail volume from the AMP test period (for most of the AMPs this was the 12-month period from 7/1/2010 through 6/30/2011) given assumed productivity gains (as determined by headquarters and local managers not by Mr. Neri's analysis) and the less stringent delivery standards. This analysis allowed the Postal Service to not only review the actual savings that might be achieved from the change in the operating window but also allowed it to factor in reduced mail volumes and changes to transportation due to lower volumes. These latter two changes could have been evaluated at any time and did not require an AMP analysis. For example, transportation routes are supposed to be evaluated annually to determine if the current transportation routes are the most efficient for that facility but the OIG has found that it is not always done.³⁵ Consequently, the savings estimated in the AMPs were capturing not only the potential savings from the longer processing window but were also capturing savings that were unrelated to the consolidation initiative.³⁶

On February 23, 2012 the Postal Service announced the results of its more in-depth analysis of the 252 facilities plus the additional 11 that had been added to the AMP review. Not all of the facilities on the original list had undergone AMP analysis. It had been decided early on that some facilities on the list were not logical candidates for consolidation (such as the Boston P&DC) and those facilities did not undergo an AMP analysis. The annexes, surface transfer points, most of the DDCs and some of the CSMPCs did not undergo AMPs because they did not fit the guidelines for such an analysis under the Handbook 408 guidelines. For several of those the Postal Service solicited Federal Register comments although the Postal Service did not provide any information about those facilities for this record, nor did the Postal Service provide the

³⁵ USPS OIG Report NL-AR-12-001, p. 2.

³⁶ Of course, there is nothing wrong with including transportation and mail volume changes in an AMP. However, it should be indicated whether those changes are driven by the consolidation. If not they should be in a notation and not included in total savings. There were some indications concerning transportation in notations within some AMPs that transportation was unrelated to the AMP

cost savings estimated for these facilities as requested. In the February 23 announcement, the Postal Service removed 35 facilities from consideration of consolidation. The AMP analysis had identified potential savings of \$105.2 million for the sub-group of these facilities that had actually undergone AMPs but the final determination was that these facilities could not be consolidated under this plan. Of the remaining 223 facilities there were 106 P&DCs or P&DFs (105 with AMPs and 1 without), one L&DC (with no AMP), 91 CSMPCs (76 with AMPs and 15 without), 12 DDCs, 10 annexes and 2 STCs. Six facilities were determined to still be under study. Of the facilities slated for consolidation, the AMP analysis estimated \$950.4 million of annual savings. Transition costs were partially though not fully identified in the AMPs. However, the largest missing cost piece was the transportation hub system. Witness Martin and Witness Williams had both stated that this would be a necessary part of the transportation system in order to meet the new service standards in the most efficient manner. However, the cost of the hub system did not appear in either Dr. Bradley's analysis or in the AMPs.

On May 17, 2012 the Postal Service provided yet another breakdown of the facilities being considered. This time broken down into three groups: 48 facilities to be consolidated (whole or in part during the summer of 2012) that were referred to as the early part of Phase I, 93 facilities to be consolidated (whole or in part) starting in February 2013 that were referred to as the second part of Phase I, and an additional 89 facilities that were Phase II facilities that would not be consolidated until 2014. The Phase II facilities were not identified. While there was a relatively substantial overlap between this list of facilities and the list of February 24, they were not the same. First there were four facilities (with potential AMP savings of \$27.3 million) that had been removed from consideration for consolidation and would not be placed on either the Phase I or Phase II lists.

Of the 48 in the early Phase I list there were 4 facilities (with AMP savings of \$26.4 million) that had undergone AMP analysis prior to the beginning of the Network Rationalization, had been approved for consolidation under the more stringent service standards and only had their consolidation delayed due to the moratorium. These four facilities, while being swept in under the Network Rationalization plan rubric, are not part

of the savings generated from changing the service standards because their consolidation did not require a change in the service standard. Of the remaining 44 facilities: 19 were P&DCs or P&DFs, 20 were CSMPCs, 4 were DDCs and 1 was an annex. (The annex was new to the list as it had not appeared in either the original list or the February 24th version.) The estimated AMP savings from this group of facilities was \$162.3 million annually although this probably overstates the savings for 7 facilities on this list the original AMP had assumed the both O&D processing would be consolidated but in this round only a partial consolidation would take place. Also, for an additional 2 facilities the location of the gaining facility had changed from the time the AMP was done.

Furthermore, the question is raised as to whether these 44 facilities could actually be considered savings from the Network Rationalization plan. An analysis by witness Kacha shows that service standards could be held at the pre-July 1, 2012 level even without these facilities in the network which implies that these changes could be made without degrading service standards and therefore should not be considered savings under this plan.

The second part of Phase I includes 93 facilities. However, this list too varies from the lists provided earlier. Included in this list are 8 facilities that had undergone AMP analysis prior to the start of this initiative, had been scheduled for consolidation but had not yet been closed by the time the Network Rationalization case was filed. The estimated (\$9.4 million) savings from these facilities are also separate from this case because it had already been determined that these facilities could be consolidated without changing the service standards. In addition there were 4 new "non-network" facilities added (by mistake based on witness Rosenberg's response to Q4 of CIR 1) since they are not technically part of the mail processing facilities, although one notes that these 4 facilities are referred to as CSMPCs like many of the other facilities already in the plan. In addition 1 annex (Jet Cove) that had been removed from consolidation consideration on February 24 was returned to the consolidation list on May 17. Of the remaining 81 facilities from the February 24 list, 39 are P&DCs or P&DFs, 29 are CSMPCs, 5 are DDCs, 7 are annexes and 1 is an STC. The combined AMP savings from those that were

on the February 24 list is \$243.4 million. Witness Kacha's analysis indicates that some of these facilities could also be consolidated without changing the service standards.³⁷

ii. AMP Studies Do No Properly Isolate Cost Changes Resulting from Lower Volume From Cost Savings Attributable to Operational Changes.

The AMPs do not isolate work hour and cost changes resulting from lower mail volume and changes resulting from changes in the operational windows. Consequently, the AMPs share some of the weaknesses of Mr. Bradley's high-level analysis.

The AMPs probably overstate the costs associated with any APWU workhours that are "saved." The base period for most of the AMPs is July 2010 through June 2011. The average hourly productive wage rate for this period used to value workhour savings does not incorporate the increasing use of PSEs in the mail processing realm since the May 2011 ratification of the APWU 2010 National Agreement. As demonstrated by APWU witness Kathryn Kobe (APWU-RT-1) in Table 3 of her testimony, the use of non-career employees doing clerk work in mail processing has climbed steadily since the ratification of the contract. In fact, the use of non-career employees in the Function 1 LDCs increased by 77 percent between March 2011 and March 2012. By March 2012 PSEs were 11.4 percent of the clerks in mail processing. With lower rates of pay and limited benefits as compared with career employees the PSE hourly compensation rate is substantially lower, as shown in Ms. Kobe's Table 4.³⁸ The share of PSE clerks has

³⁷ See APWU-LR-N2012-1/NP6, Scenario Files, Shoot for 350.

³⁸ Mr. Smith takes issue with the weighting in Ms. Kobe's Table 4, stating that based on data from the Time and Attendance Collection System (TACS) the PSEs are currently working an average of 29 hours per week (Attachment 2 of the Surrebuttal Testimony of Marc A. Smith), which he compares to the 40 hour week of full-time clerks. However, Mr. Smith has failed to provide information from the TACS data on the actual average weekly hours of the career clerks. One cannot use the standard 40 hour workweek in this calculation since the leave benefits are loaded onto the actual number of workhours. It is notable that in Attachment 1 of his original testimony Mr. Smith assumed that clerks had an average of 33.4 productive workhours per week. In page 2 of Attachment 1 of his Surrebuttal Testimony Mr. Smith confuses things further by weighting, not with relative mail processing hours, but with hours for all clerks. That would include clerks performing tasks in Function 1, Function 3, Function 4, Function 5, Function 7 and Function 8. (One notes that during PP12, there were 25 percent

grown steadily and has not reached the contractual limit. Postal Service managers have incentives to maximize use of these workers in mail processing operations, including increasing scheduling flexibility and lowering the costs of mail processing. Use of PSEs should mitigate the service-wide retirement-related costs since the PSEs do not participate in retirement-related benefits that tend to increase the Postal Service's long-term liability. (See witness Kobe's discussion APWU-RT-1 at 22-24.)

Even using Mr. Smith's assumptions, Postal Service use of PSEs will lower the average hourly compensation in mail processing. This reinforces the concern that the Postal Service has failed to establish a baseline incorporating all the savings it could achieve without changing service standards before it started to make estimates of the savings that could be achieved by making only those operational changes that would damage the service standards.

The Postal Service continues to rely upon Dr. Bradley's high-level initial \$2.6 billion cost savings, despite the testimony from several Postal Service witnesses that the evaluation of the cost savings associated with the Network Rationalization plan could not be complete until the time-tested AMP process was finished. The \$2.6 billion was used when this case was filed; used again when the February 2012 AMP analysis results were announced; and used once again as the basis of the Phase I cost projections discussed by witness Rosenberg in her response to CIR Q. 3 on June 4, 2012. This estimate continues to be used to justify the reduction in service planned despite Dr. Bradley's downward revision in his supplemental testimony (USPS-ST-4). Ms. Rosenberg explained that the estimated \$1.2 billion in cost savings from Phase I is based on pre-AMP information, and acknowledges that the supplemental testimonies of Mr. Smith and Mr. Bradley provide better estimates of cost savings.³⁹ Aside from the fact that this estimate of annual savings from the Phase I implementation of the rationalization plan suffers from all the same problems as Dr. Bradley's initial analysis and are heavily dependent on the questionable productivity assumptions of Mr. Neri, the Postal Service

more career clerks assigned to Function 4 as there were assigned to Function 1 while there are 16 percent more PSEs working in Function 1 than there are working in Function 4.) This calculation tends to overweight the career clerks in the total.

³⁹ Tr.9/2739 and 2760.

has never even tried to reconcile this \$1.2 billion claim with the underlying AMP savings of \$406 million for these Phase I facilities.

When asked why he chose to continue to use the \$2.6 billion savings rather than the \$950 million savings generated by the AMPs, Mr. Williams claimed that this was because there were “major areas of savings that the AMP process does not examine.”⁴⁰ As an example, Mr. Williams asserts that the AMPs do not assess any estimated increase in productivities for any operations that remain behind in the consolidated site or for any operations that are not gaining additional volume at the gaining site. As Ms. Kobe shows in Appendix A of her testimony, there are very few losing facilities that will maintain any mail processing workhours after consolidation. Almost all the facilities show that both originating and destinating operations will be consolidated. For the ones that show only one operation, it is the destinating mail being consolidated and those are mostly facilities whose originating mail was consolidated at an earlier date. For the identical reason, the gaining facilities tended to have the bulk of their Function 1 operations evaluated for productivity gains because the gaining facilities were likely receiving both the originating and destinating operations from one, or likely more than one, losing facility. Also, very few facilities did not undergo some sort of evaluation during this process. As Ms. Kobe’s Appendix Table B shows, less than 25 P&DCs were not gaining facilities for at least some operations. It is unlikely that these facilities could generate the level of savings that would be necessary to make up the difference between the initial estimate and the AMP savings numbers.

Mr. Williams seems to depend mostly on the results of past Post Implementation Reviews (PIRs) as compared with the original AMP estimates to support his desire for the higher savings numbers to be true. Yet, as the OIG’s January 9, 2012 Audit report cited, the large variance between the initial savings projections of the AMPs and the actual savings was due to the inclusion of concurrent initiatives savings in the totals.⁴¹ In addition a review of just a few of the PIRs for this case revealed several errors that overstated the calculated PIR savings. Finally, Witness Weed also notes the major

⁴⁰ Williams Response to Commissioner Taub, Tr. 2/422.

⁴¹ U.S. Postal Service Past Network Optimization Initiatives Report Number CI-AR-12-003, January 9, 2012

volume changes that were incorporated in the PIR savings numbers.⁴² In his response to POIR 8 Q. 1, Mr. Weed states “[t]he PIR review process does not adjust for changes in the base volume. Work hour reductions resulting from the overall volume decline are not segregated from the reductions tied directly to consolidation....This gives the appearance that this work hour reduction is caused by the consolidation.” He also points out that in “addition to the change in volume, the other operational changes are not considered in the AMP PIR process. For example, if new, more efficient equipment is added to the gaining plant, the effect of the new equipment is not segregated in the PIR analysis. Another example would be when mail is moved to a different mail-processing (e.g. transferred to the NDC) or customer-service operation.”⁴³

USPS witness Williams is basing a very high risk strategy on a very weak factual foundation. The Postal Service has not presented the cost/benefit analysis that would allow Mr. Williams or the management team to properly evaluate whether degrading the Postal Service’s service standards is going to be worth the lost revenues , the lost contribution and the lost trust of customers. That is primarily because the Postal Service has never separated the cost savings it could achieve without degrading its service standards from those that can only be achieved by degrading its service standards. Since the revenue and contribution losses go hand-in-hand with the degradation of the service, this would seem to be a vitally important step that has been skipped.

C. The Postal Service Has Provided No Reliable Estimate of Transportation Savings

i. The Postal Service Has Provided No Estimates of the Cost or Savings Expected from the Creation of Transportation Hubs

The consolidations expected from full implementation of MPNR will necessarily impact mail transportation. During the proceedings in this case USPS witness Williams explained how the Postal Service would address this impact: “we understood for efficient transportation we would need to establish hubs to drive efficiencies around transportation.

⁴² PRCWIT-T-1 at 19:4-12.

⁴³ POIR 8, q 1

That was understood near the very beginning of our analysis.”⁴⁴ Despite understanding the need for transportation hubs from “the very beginning” there is no mention of hubs in any of the testimony presented by the Postal Service in support of its proposal in this case.⁴⁵

USPS witness Cheryl Martin (USPS-T-6) provided testimony concerning the impact of Network Rationalization on mail transportation. However, Martin provided no information, including possible routes, costs, percentage of mail to be covered by hubs or likely locations. Ms. Martin explained that this information was not available because “the estimated number of intermediate locations or hubs that will be required to support the rationalized network will depend on the outcome of the AMP review process.”⁴⁶ However, even after the AMPs had been completed and the location of some, if not all, the hubs had been identified⁴⁷, insofar as there would be costs associated with hubs in the new network, these costs are still not reflected in Ms. Martin’s revised transportation estimates.⁴⁸

The transportation hub system that will have to be established as a result of MPNR is at least partially identified in the AMPs, although not all the costs are included. For example, in looking at the AMPs associated with the Capital Metro area, the AMPs state that the following losing facilities will be maintained as transportation hubs: Asheville, Athens (GA), Fayetteville, Florence, Kinston, Norfolk and Rocky Mount. In some cases, at least some of the costs of running the hubs have been incorporated into the AMP numbers (the Florence, Kinston and Rocky Mount AMPs include assumptions about maintaining some Function 4 clerk and mailhandler hours that appear to be for the purpose of staffing the hub).

In other cases it is explicitly stated that the costs have not been included in the AMP cost numbers although those costs seem to have been approximated. For example, the Norfolk to Richmond AMP states, “[t]he transportation analysis is based on the

⁴⁴ Tr. 2/270.

⁴⁵ Tr. 2/271.

⁴⁶ Tr. 4/1069.

⁴⁷ Tr. 8/2602-2603.

⁴⁸ Tr. 8/2570.

assumption that the current Norfolk P&DC facility will be retained to serve as a processing facility for originating and destinating priority mail and a dispatch hub for the 233-237 service area. Full PVS operations will remain in Norfolk to support the dispatch hub along with establishing a hub operation at the Hampton Main Post Office.” But it then goes on to state “[t]he mail processing hours needed to run the hubs will be an additional cost beyond what is currently being used and what is reflected in the AMP study. With 26 employees and 45,370 hours needed to operate the transfer hubs the additional cost is estimated to be \$1,950,910.” The Asheville to Greensboro AMP states “[t]he transportation section also includes a line item to account for the additional workhour costs associated with operating the dock transfer hub in Asheville. The mail processing hours needed to run the hubs will be an additional cost beyond what is currently being used and what is reflected in the AMP study. With 12 employees and 1 SDO, 23,256 hrs needed to operate the transfer hub in Asheville; the additional cost is estimated to be \$904,594.”

In other cases it is unclear whether the hub costs have been fully included or not. For example in the Fayetteville AMP the following observations are made about the transportation runs but it is unclear what assumptions, if any, have been included in the costs to accommodate these changes. “Currently the contract [for the Charlotte P&DC to Fayetteville P&DC] calls for six (6) straight trucks. This requirement will need to be altered to ten (10) fifty-three (53) foot tractor – trailers (3000 cube). This may add additional cost to the contract.

The number of trips and schedules would also have to be adjusted to accommodate the additional volumes. Fayetteville would need eight (8) AM trips to transport mails to Fayetteville. It will also require eight (8) trips in the evening to bring mails into Fayetteville. The estimated annual miles increase [redacted]” “By using Myrtle Grove Station in Wilmington as a hub, a new contract will be needed to transport mail in and out of Charlotte. This contract will require four (4) fifty-three (53) foot tractor – trailers (3000 cube). The schedule will require four (4) AM trips to transport mails to Wilmington. It will also require four (4) trips in the evening to bring mails back into Charlotte P&DC.”

It is clear that the Postal Service has recognized the possibility of additional costs to maintain the service for some of its mailing services products but seemingly has not included the cost in the AMP. For example in the Florence AMP the statement is made that “Express Mail operations will be processed at the Columbia P&DC. The current Express Mail operation will be expanded to include 295 destinations. Express Mail dispatch schedules from Columbia P&DC to Florence P&DF will be adjusted accordingly to protect service standard.”⁴⁹

IV. Market Research Indicates That Lost Revenue Will Substantially Erode The Benefit Of Cost Savings From MPNR

In July 2011 the Postal Service contracted with Opinion Research Corporation (ORC) to conduct qualitative and quantitative market research to determine the likely effect of service changes on postal volumes and revenues. USPS-LR-N2012-1/70. The original Statement of Work provided that data for the study would be collected by the end of August and that testimony would be prepared by ORC within five days thereafter. Whiteman Responses to Questions Posed During Oral Cross-Examination, at 2. “The original plan was to move quickly and to complete both qualitative and quantitative analyses in five weeks.” *Id.* at 1. The contract was awarded to ORC on July 22, 2011, and data collection was conducted between August 5 and September 13, 2011. *See id.* at 3; Elmore-Yalch Tr. 3/622. The objective of the research was to measure the effect of the change in First Class Mail service standards resulting from MPNR. *Id.* Tr. 3/604. It was “very much focused on what was the impact of the changes to first class mail service standards on the use of the Postal Service products across the different applications.” (Elmore-Yalch Tr. 3/605).

The preliminary forecasts of volume losses due to MPNR generated by the quantitative research were delivered to the Postal Service on October 7, 2011. *See id.* at 3. Those results indicated that the MPNR would have a “massive, massive impact on the business.” Whiteman Tr. 3/866. First Class Mail volume was forecast to decline by 10.2 percent (USPS-LR-N2012-1/NP14; Whiteman Tr. 3/844. In total, postal revenues

⁴⁹ Florence AMP USPS-LR-N2012-1/73

would decrease by \$5.2 billion, and net contribution would decrease by \$1.9 billion. USPS-LR-N2012-1/NP14; APWU XE-1 (Tr.4/906).

In accordance with their contract, ORC promptly began preparing testimony based on their qualitative and quantitative research. But after the preliminary results of the quantitative research had been delivered to the Postal Service, ORC was told to stop preparing that testimony and to conduct a second Phase of quantitative research using a revised concept statement and slightly different questions. Elmore-Yalch Tr. 3/597. According to Witness Whiteman, this was because it was determined that the initial results from the quantitative research were not reliable and not credible. Whiteman Tr. 3/868. ORC Senior Vice President Elmore-Yalch, on the other hand, doesn't "want anybody to think this was not good research. This was very good research." Elmore-Yalch Tr. 3/863, lines 5-7. She firmly believes "that the data they have is very useful and can be used for other strategic business decisions that they have to make." Elmore-Yalch Tr. 3/677, lines 6-9. The only steps remaining to make the data final were the cleaning steps of removing outliers in the data and eliminating data entry errors to make sure the data is valid. Elmore-Yalch Tr. 3/626-627.⁵⁰

A revised Statement of Work was issued on October 7, 2011, providing for a new round of data collection, for Phase 2 of the quantitative study by ORC. See Whiteman Responses to Questions Posed During Oral Cross-Examination, at 3. The objective of Phase 2 of the study was the same as the objective of Phase 1 Elmore-Yalch Tr. 3/615. "The primary difference [between Phase 1 and Phase 2] was the verbiage that was in the concept statement that was read to the respondents." Id. 3/606. The questions were slightly different. Id. The Phase 1 concept statement informed people participating in the survey that:

As a result of declining mail volume, the cost to continue providing this level of service is becoming unsustainable, contributing to major budget deficits for the Postal Service. In the past two years, the Postal Service has had budget deficits of over \$8 billion and expects to have a similar budget deficit this next year. To

⁵⁰ Witness Elmore-Yalch testified that when the Phase 2 data were cleaned, there was no significant difference between the results before and after the data were cleaned; the first pass is "fairly reliable." Elmore-Yalch Tr. 3/679.

address the budget deficits, the Postal Service is exploring several changes, including:

- Legislative reform to change government requirements to pre-pay health and pension benefits
- Eliminating Saturday mail delivery to homes and businesses and closing many small post offices well shifting retail access to alternative locations and channels

The Postal Service is also considering revising the service standards for First-Class Mail within the continental U. S., including:

- Delivery in your local area not delivered the next delivery day will be delivered on the second day
- Delivery outside the local area up to 200 miles which now takes two days will continue to be delivered on the second day .
- Delivery to S destinations 200 to 1000 miles which now takes two days will take three days .
- Delivery to destinations over 1000 miles which now takes three days will continue to take three days.

And For those living in Alaska and Hawaii, delivery to anywhere in the continental US will continue to take 4 days.

In addition, local Periodical Mail, primarily newspapers, is currently transported along with First-Class Mail. The proposed change will mean that local delivery this mail now delivered on the next day will be delivered on the second day. All other Periodical Mail delivery schedules will not be affected.

Compare USPS –LR-N2012-1/70, with Elmore-Yalch Testimony, USPS-T-11, Appendix E.

This concept statement, which is also called a “First Class Mail Change Statement. (Id.) was omitted from the Phase 2 protocol; data for the quantitative survey were again collected; and the forecasts based on the Phase 2 data were presented to the Postal Service on November 22, 2011. See Whiteman Responses to Questions Posed During Oral Cross-Examination, at 3. “The transition between research for Phase 1 and Phase 2 was ... quick...” Whiteman Responses to Questions Posed During Oral Cross-Examination Tr. 3/814-16. “[S]ome of the work undertaken for the quantitative part of Phase 1 (the qualitative part of Phase 1 was utilized completely in the market

research testimony and in this docket), such as the questionnaire design, some programming of the questionnaires, the general sampling plan, computation of the forecasts, etc. – most of section 6 within USPS-T-11, could be utilized in Phase 2 with modest updates.” Id. at 2-3.⁵¹

With the elimination of the Phase 1 concept statement, the Postal Service placed itself in the position of proceeding without completing the only research they had begun that would have confirmed the cumulative effects of ongoing Postal Service initiatives.

Whiteman Tr. 3/868-869. Thus, there has been:

- No evaluation of the combined effects of Retail Optimization (N2011-1) and 6-to-5 day delivery and the proposed changes (Williams Tr.2/113, 118)
- No evaluation of the combined effects of the proposed changes and the exigency rate increase. (Williams Tr. 2/114)
- No evaluation of the combined effect of N2010-1 and the current proposal (Williams Tr.2/117)
- No evaluation of the combined revenue loss from the changes in N2010-1, N2011-1, and N2012-1. (Williams Tr. 2/119)
- No consideration of combined impact of N2011-1, N2010-1, reduced number of collection boxes and exigency based rate increase. (Williams Tr. 2/140)
- Consumers in Phase 2 quantitative research were not asked about behavior if service standard changes and five day delivery were implemented. (E-Y Tr. 3/497).
- Participants in Phase 2 quantitative research were not informed about a possible exigency rate increase (E-Y Tr. 3/498)
- The Postal Service does not know whether eliminating Saturday delivery and implementing the service changes may exceed the sum of volume losses predicted for each individually. (Whiteman Tr. 3/834).
- Postal Service does not know what the impact on mail volume would be if service standard changes are made, post offices closed and Saturday delivery eliminated. (Whiteman Tr. 3/836).

⁵¹ The cost of Phase 2 was approximately \$40,000 lower than it otherwise would have been because ORC was able to use elements of Phase 1 in Phase 2. Whiteman Responses to Questions Posed During Oral Cross-Examination Tr. 3/814-16 at 4.

- No one at USPS has evaluated the combined impact on customer service of the proposed closings from MPNR and the RAOI. (USPS Tr. 6/2134)

The Phase 2 quantitative research results were quite different from the results shown by Phase 1 of the study. Witness Whiteman testified: “[o]verall, we conclude that the impact on volume, revenue and contribution from the changes in the service standards will be a reduction of 2.9 billion pieces or 1.7 percent of total volume, producing a loss in revenue of \$1.3 billion or two percent, and a loss in contribution of \$499 million or two percent, using FY2010 volume, revenue, and contribution data.” (USPS-T-12 at 7)

Witness Elmore-Yalch attempted in her surrebuttal to provide support for the proposition, sponsored primarily by witness Whiteman, that the Phase 2 estimate of likely lost volume is more likely to be accurate than the Phase 1 estimate. We find these attempts unpersuasive, and troubling, for several reasons. First, we observe that ORC has persisted in using a probability adjustment to adjust, downward only, the estimated effects of the proposed changes. This it does despite the recent admonition of the Commission in Case No. 2010-1 that the Commission is very skeptical of the validity of such subjective and one-sided adjustments. See, e.g., Elmore-Yalch Surrebuttal Test. at 3, 15, 21.

In the same vein, witness Elmore-Yalch’s response to the criticisms of Professor Crew leave us concerned that ORC’s research has systematically been biased downward. For example, ORC implicitly acknowledges that it is inappropriate to use a normal curve to establish confidence intervals for a sample that is one-sided. To blunt the effect of that point, witness points to the fact that a majority of the responses obtained are not statistically different from zero. *Id.* at 4. But this wholly subjective response to Professor Crew’s point does not change the fact that no appropriate statistical confidence interval was established.

Completely lacking from witness Elmore-Yalch’s surrebuttal testimony is any acknowledgement that results could be even worse than the estimated \$2.6 billion loss of revenue predicted by Phase 1 research. If the Postal Service wishes to rely on confidence intervals based on normal curves in these circumstances, then it is important

for it to recognize the very substantial downside risk that it will lose more revenue by the proposed changes than the potential cost savings could justify.

Even more troubling is witness Elmore-Yalch's suggestion that there is possibility that the lost revenue will be even less than the \$1.7 billion estimated by Phase 2. Given a one-tailed distribution of responses heavily weighted toward negative reactions to the proposed service changes, it is counter-intuitive to suggest that the more likely error is an overestimate of volume loss. This is particularly true in the face of the Phase 1 results. Phase 2 was carefully controlled to require respondents to focus just on First Class Mail service standard changes. The world is not so controlled; and publicity about the proposed elimination of Saturday delivery and about post office closings ensures that the laboratory conditions that produced the Phase 2 results will not exist in the real world.

V. MPNR Will Limit Future Business Opportunities

APWU Witness Marc Schiller (APWU-RT-2) raises three concerns:

- a risk of much more volume loss in First Class Mail (FCM), and, a volume loss in other classes of mail, particularly in parcels.
- a risk that collective changes in service perceived by customers and compounded by the growing awareness among customers of the entire context of the difficulties facing the USPS.
- And a real risk of opportunity costs from dismantling a network with significant inherent value for the future of parcels.

Mr. Schiller presents an analysis of the number of 3-digit Zip Code Origin/Destination Pairs moving slower, faster, or unchanged in the original the Postal Service proposal and later revised in his supplemental testimony APWU-ST-1 (Table 1, page 3) to show the effects of Phase 1 under the final rule. Mr. Schiller also provides the results of a modeling effort to suggest possible degradation of performance on Priority Mail (Table 2, page 21, APWU-RT-2). The modeling effort was necessitated because the Postal Service had not provided the same kind of O/D pair standards for Priority Mail, although it indicated that service on some pairs may change (response to APWU/USPS-T1-34).

Mr. McCrery (USPS-SR-T3) responded that “Customers will adjust to the elimination of most overnight First-Class Mail service because it is not a critical attribute to them. Instead, reliability, ease of use/convenience, and affordability are what they deem critical attributes. If customers need day-specific delivery, they have generally indicated that they will exercise the option of sending First-Class Mail a day earlier or using a more expedited postal service.” (page 5) While it may be true that some FCM mailers may adjust because speed is not critical or they can mail earlier, this does not address the difficulty of online retailers whose clock starts running with a customer order and who measure performance based on cycle time (APWU-RT-2, page 14). Such shippers may be negatively impacted by

- a) Increase in time and costs associated with the transport of shipments from the customer facility to a USPS induction point due to greater distance travelled.
- b) Costs of reprogramming software used to either determine the appropriate carrier/service combination for individual shipments or inform the purchaser of expected delivery day.
- c) Increased customer phone calls and complaints, particularly during transition, driving increased costs.⁵²

Such problems will drive these customers to seek alternatives and consider USPS competitors’ products.”

Mr. McCrery assures us that the Postal Service will not allow performance degradation on package products generally (although First Class Package Service will mirror the revised and slower FCM standards) and Priority Mail in particular. He tells us that USPS will put in the additional resources – including flying mail – to assure that performance remains as good as today.

However, MPNR would only affect the operations network for Priority Mail by reducing the number of processing and distribution facilities and may result in increases in the percentage of Priority Mail processed in auxiliary facilities or transported by air; both of these constitute opportunities for improved consistency of Priority Mail service, which will be a post-MPNR focus.

⁵² APWU-RT-2 at 14.

Unfortunately, the Postal Service is still not in a position to specifically detail the problems, solutions, changed expectations by O/D pairs, or the costs associated with processing in auxiliary facilities or increased air transportation. It is truly risky to depend upon after-the-fact analysis making adjustments after commitment to a plan and as the plan is implemented. Such a failure puts a growing and profitable product at risk, first by potential degradation in performance and second by the cost and price implications of maintaining or restoring performance. As Mr. Schiller notes there are real growth opportunities that can come with improvements in package products and performance.

Mr. McCrery generally agrees with Mr. Schiller that there is great potential for growth in package service. Mr. Schiller is concerned that disinvestment in the network is perhaps the result of a commitment to become “a last mile” delivery company working for UPS, FedEx, and others with little end-to-end capabilities and few direct relationships with the mailing customers and little ability to compete for business in many segments of the package market. Contrary to much of what we heard earlier, Mr. McCrery testified that the Postal Service wants more than the last mile piece of business; but until USPS improves its offerings and performance, the Postal Service is happy to deliver the last mile. [get transcript quote]. So it is all the more important that the Postal Service design its future network – not based solely on the fewest letter sorting machines needed to process declining letter volumes – but with the number and types of network nodes it will need to grow the package business and any other future product offerings.

While Mr. McCrery may disagree with Mr. Schiller about the size of various package segments and how quickly those markets might grow; there is no disagreement that the markets are large and growing and over time offer to the Postal Service billions in revenue in profitable products. To assure Postal Service opportunities in the package market requires more analysis and planning in network design than is evidence in this Network Rationalization initiative.

VI. The Postal Service Has Failed to Consider Viable Alternatives that Would Produce Substantial Savings and Preserve Service Standards

Unfortunately, the Postal Service did not perform any thorough study of alternative network rationalization plans that could have saved the Postal Service substantial costs but with less disruption of service and less risk of major revenue losses. “The analysis performed suggested the savings potential from maintaining some level of overnight service standards, with some relaxation of overnight relationships was not as great as the proposed change, and based on the financial condition of the Postal Service, as well as the forecasts related to First-Class Mail volumes, the organization determined to more fully evaluate the potential opportunity based on the proposed network laid out in this docket.” USPS-LR-N2012-1/47; Williams Tr. 2/138. As we have seen from the work of Decision Analysis Partners, however, this judgment by the Postal Service was premature and unfortunate.

Dr. Kacha produced a model and ran several scenarios. Figure One (page 4 APWU-RT-3) shows the results of scenarios. An inflection point around 350 facilities indicates a point beyond which it would be difficult to maintain current service standards. It clearly indicates that the Postal Service could achieve further consolidations and significant savings through the standard AMP process short of degradation of service standards. The supplemental testimony of Dr. Kacha (APWU-ST-2) also indicates that the Postal Service could achieve the summer 2012 consolidation in Phase 1 of its plan without changing service standards.

VII. Conclusion

It is clear that the Postal Service proposal in this docket does not properly balance the its business needs with the needs of the public in postal service. Accordingly, we recommend that the Postal Service be advised to make the following revisions as it moves forward.

In order for the Postal Service to effectively demonstrate the impact of a change in the nature of postal services and to establish that the proposed change satisfies the policies and requirements of Title 39, USPS needs to establish accounting mechanisms that allow it to properly credit savings to the appropriate driver. For example, work hour savings that occur because mail volume falls should be credited to falling volumes of

work and not to other initiatives such as consolidations. Post Implementation Reviews – used frequently in Postal Service presentations to assist in various costing – are notorious for measuring change from all causes between two points in time without crediting cost changes to their drivers which may include falling mail volumes and a dozen separate initiatives which effect costs. Everything gets credited to the consolidation.

In support of is network rationalization proposal at issue in this case, the Postal Service is including all the savings that might occur through consolidations and operational changes. Many of the consolidations could occur without changing service standards. Some transportation changes and savings might occur without the service standard changes. Those savings should be itemized separately. The consolidations and operational changes that can only occur if there is a degradation in service standards should be totaled separately and after deducting likely loss in contribution from lost mail volume – weighed against the degradation in service to determine the worth of this initiative (or any future network revisions).

USPS needs to move carefully and step-wise through consolidations. Before the next set of consolidations, it should detail the impacts on other products – particularly packages - and any remedial steps to assure performance with their associated costs.

The APWU contract was designed to achieve savings and productivity increases by having a more flexible workforce that could be scheduled to match workload. USPS analysis of productivity increases due to an elongated operating window uses rigid work rules for scheduling – more rigid than what was possible under previous CBAs and far more rigid that what is possible under the current CBA. Having launched Phase 1, the Postal Service has a laboratory in which it could test the assumptions and methods used in this case. For example, the Postal Service could study what productivity increase it can achieve from elongation of operating windows as compared with the old windows using new scheduling flexibility.

The Postal Service needs to provide the details, design, and costs of hubs that will be necessary as the network is changed. It should provide some mail entry and distribution capabilities at the hubs to provide quick delivery particularly for periodicals

and certain package products. This is particularly critical for periodicals where the July 1, 2012 change in service standards will potentially degrade the service of a high percentage of periodicals volume and will degrade service further in 2014.

Respectfully submitted,

Darryl J. Anderson
Jennifer L. Wood
Counsel for American Postal Workers Union, AFL-CIO