Postal Regulatory Commission
Submitted 11/27/2013 5:20:45 PM
Filing ID: 88451
Accepted 11/29/2013

Before The
POSTAL REGULATORY COMMISSION
WASHINGTON, D.C. 20268-0001

RATE ADJUSTMENT DUE TO EXTRAORDINARY OR EXCEPTIONAL CIRCUMSTANCES	Docket No. R2013-11

RESPONSES OF THE UNITED STATES POSTAL SERVICE
TO QUESTIONS 1-7 OF PRESIDING OFFICER'S
INFORMATION REQUEST NO. 10
(November 29, 2013)

The United States Postal Service hereby provides its responses to Questions 1-7 of Presiding Officer's Information Request No.10, dated November 21, 2013. Each question is stated verbatim and is followed by the response. The responses to Questions 1-2 and 6-7 are sponsored by Stephen Nickerson; the responses to Questions 3-5 are institutional responses of the Postal Service.

Respectfully submitted,

UNITED STATES POSTAL SERVICE

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November 29, 2013

1. These questions pertain to Nickerson Statement Attachment Nos. 11 and 4. Attachment No. 11, Contribution by Class of Mail FY 2014 AR, (Jan 26, 2014 implementation) shows total revenues of $66,174 million and total costs of $72,498 million. The difference between total revenues and costs, the projected deficit, amounts to $6,324 million. In Attachment No. 4, that same $6,324 million deficit is the first entry in the column headed "2014 AR Forecast (Jan 26, 2014)," and the bottom row of that column shows an end of year Cash Balance of $2,984 million.
   a. In Attachment No. 11, the forecasted contribution from the two High Density Saturation products, Letters and Flats/Parcels, respectively, is $481 million and $1,197 million. If higher than forecast volumes were to materialize for these two products and their actual contribution turned out to be, respectively, $500 million and $1,200 million (*i.e.*, actual contribution higher than forecast by $22 million), would it be correct to expect that (i) the total deficit as shown on Attachment Nos. 11 and 4 would be reduced by $22 million, from $6,324 to $6,302 million, and (ii) the end of year cash balance on Attachment No. 4 would increase by $22 million, from $2,984 million to $3,006 million, or would some of the items shown on the rows of Attachment No. 4 likely be affected by such a change in Attachment No. 11? If, under the assumed volume and contribution changes for these two High Density Saturation products, some amount other than $3,006 million would represent a better estimate to the cash balance on Attachment No. 4, please provide that amount and explain its derivation.
   b. Attachment No. 11 projects a negative contribution from Standard Flats of $251 million, and a cost coverage of only 89.7 percent. If the coverage on Standard Flats were increased to 100 percent and the aggregate $251 million deficit on account of Standard Flats correspondingly eliminated, would you expect (i) the aggregate contribution from Standard Mail in Attachment No. 11 to increase by $251 million, and (ii) the total deficit in Attachment Nos. 11 and 4 to be reduced by $251 million, from $6,324 million to $6,073 million? If not, please provide your projection of the expected aggregate contribution from Standard Mail and the resulting total deficit on Attachment Nos. 11 and 4.
   c. If the contribution from Standard Mail shown in Attachment No. 11 were to increase and the total deficit were to be reduced, would the change in the total deficit on Attachment No. 11 flow through to the end of year cash balance in Attachment No. 4 (under the column 2014 AR Forecast Jan 26, 2014) and increase the cash balance shown there by the same amount of the reduction in the total deficit? If not, please provide and explain your projection of the end of year cash balance that would result from a total deficit of $251 million on Attachment Nos. 11 and 4, or such other total deficit as projected in your response to question No. 1.b., above.

RESPONSE OF STEPHEN J. NICKERSON
TO PRESIDING OFFICER'S INFORMATION REQUEST NO. 10

RESPONSE

(a) The math in the above example is correct. All other things being equal, the (i) deficit would be reduced by $22 million and the (ii) end of year cash balance would increase by $22 million. There would be some minor variation largely because all of the costs are not volume variable.

(b) The question does not describe how the elimination of the negative contribution is achieved. Assuming all other things constant, then the math is correct and the answer is essentially "yes" with some minor variation for non-volume variable costs. Aggregate contribution would (i) increase by $251 million and the cash deficit (ii) would be reduced by $251 million. If the cost coverage is achieved as the result of a price increase, then the net contribution and cash increases would be lower as a result of lower volume.

(c) All other things (including volume) being equal, additional contribution from Standard Mail (or any other product) would flow through to the year-end cash balance, except for any variation due to non-volume variable costs.

2. As the Nickerson Statement notes at pages 4 and 5, Postal Service borrowing now has reached its statutory limit and liquidity now reflects the Postal Service's cash balances, as shown in Table Nos. 3 and 4. At page 5, lines 5-8, Mr. Nickerson explains: This [liquidity] problem is not adequately addressed in a normal price change for market dominant products, where price increases are constrained by inflation, as costs are also generally rising with (or above) inflation. If the Postal Service changed prices annually in a manner that comes closer to achieving the maximum contribution available to it under the price cap, would the Postal Service's liquidity be less constrained by the inflation-based price cap? If not, please explain why the Postal Service's liquidity would not be less constrained.

RESPONSE

Almost by definition, if the Postal Service could obtain more contribution from its annual increases under the price cap, the effects on liquidity would be beneficial. But it is far from clear that any feasible increase in contribution under the current price cap regime would be large enough to have a material effect on liquidity. Further, the premise of the question appears to be that the Postal Service is materially sub-optimizing contribution under the available price cap, and the Postal Service disagrees with that premise. Keeping a long-term perspective firmly in mind, the Postal Service always tries to use its price cap authority to obtain as much additional contribution as is feasible in accord with the many factors and objectives of the law.

6. At page 12, lines 5-6 of his statement, Mr. Nickerson states:

This [expected available liquidity of $4,161 billion] remains well below the level of cash that a financially sound private sector company would have, as demonstrated above.

a. If the Postal Service's underwater products continue to result in annual losses of hundreds of millions of dollars, and the expected available level of liquidity will be as low as Mr. Nickerson indicates, how long will it be before the Postal Service will need another exigent price increase?

b. Please explain whether the Postal Service expects that the proposed exigent price increases for First-Class Mail (as well as other products with high coverage), will hasten or retard any long-run decline in the volume of First-Class Mail (and those other highly profitable products).

RESPONSE

a. When and for what reasons the Postal Service might need to file a future Exigent request cannot be determined at this time. The Postal Service currently has no plans for a future additional Exigent price increase.

b. Price increases, whether Exigent or otherwise, always result in a volume decline when compared to the no rate increase scenario, irrespective of whether the product has high or low cost coverage. Therefore, compared to no rate increase, the Exigent rate change can be expected to hasten a volume decrease. For Market Dominant products, with a relatively inelastic demand, a price increase of the type proposed will increase the Postal Service's contribution and liquidity at a time when it is urgently needed.

7. In response to Presiding Officer's Information Request No. 5, question 2(b), the Postal Service states that "if the Postal Service were to achieve both sets of proposed rate adjustments, CPI and exigent, we hope to be able to maintain sufficient liquidity through 2017 such that the gains from this case would represent the full and final amount of net contribution that the Postal Service expects to request for volume losses from the 2008 – 2012 period."

a. Please provide the underlying assumptions in forecasting revenue, costs and liquidity through FY 2017?

b. How does the $1.78 billion estimated from the exigent rate increase sufficient to maintain liquidity compare with the $19.7 billion total FY 2016 savings estimated in the USPS Five Year Business Plan (April 2013) needed to gain financial self-sufficiency.

RESPONSE

a. In order to maintain a functional level of liquidity into 2017, the Postal Service must achieve all of the estimated savings associated with its operational and strategic initiatives, including network savings, retail savings, and delivery savings, as described in the Postal Services' Five Year Business Plan, published in April 2013. Market Dominant price changes after 2014 are assumed to be at CPI. No legislative initiatives or relief is assumed. It is also assumed that the Postal Service continues to default on its legally-mandated retiree health benefit prefunding obligation.

b. While the Exigent price increase will provide some much needed short term liquidity, the increase alone, will not allow the Postal Service to achieve financial self-sufficiency.

The Five-Year Business Plan outlines continuing management efforts to improve productivity and reduce costs including, but not limited to Network Rationalization (a reduction in the number of mail processing locations and distribution plants, and the rescheduling of transportation routes), POStPlan (which keeps existing Post Offices in place, but with reduced retail hours to match customer use) and Delivery Optimization (which consolidates delivery offices and routes and expands centralized delivery). The Plan further identifies a number of significant cost saving initiatives that require legislation, including the implementation of a Postal Service-sponsored health care plan fully integrated with Medicare, refund of Federal Employee Retirement System (FERS) overfunding, and transition to a six-days- per-week delivery schedule for packages and five-day mail delivery.

As the timely passage of comprehensive postal reform legislation has not occurred in the past three years, nor can it be assured to occur at any time in the future, the Postal Service has been forced to consider additional actions to assure that it has sufficient liquidity to continue operations, which is why the Exigent price increase is being proposed.

3. At page 9, lines 17-19 of his statement, Mr. Nickerson states:
During 2013, the Postal Service worked to maximize the number of lower-cost non-career employees under the recently enacted contracts with its four largest unions. In 2014, we will capture the full year effects of that maximization.

a. When did the "recently enacted contracts: referred to in this statement become effective?
b. Does "maximize the number of lower-cost non-career employees under the recently enacted contracts" mean that the Postal Service currently is adding a significant number of newly hired employees to its payroll? If not, please explain. If so, please indicate the number of newly hired employees through September 30, 2013.
c. Does the Postal Service need to hire new employees in order to process and deliver the current volume of mail?
d. Under these "recently enacted contracts," can the Postal Service lay off any of its career labor force and replace them with non-career employees?

<u>Response</u>

a. The effective dates of the new contracts are as follows:

APWU – May 23, 2011

NRLCA – July 3, 2012

NALC – January 10, 2013

NPMHU – February 15, 2013

Also, please note that the NLRCA, NALC, and NPMHU agreements were determined by an arbitration panel.

b. Yes. In fiscal year 2013, the Postal Service added approximately 26,000 noncareer employees, bringing the total non-career complement to about 127,000.

c. Simply because volumes are declining does not mean that there is never a need to hire new employees to replace the large number of employees who have left the Postal Service. New employees are hired when necessary to process and deliver the mail, based on local operating circumstances. Over the course of FY 2013, total bargaining unit complement (career and non-career) declined by over 8,000 employees. The increase in the non-career workforce was offset by the attrition of approximately 38,000 career bargaining unit employees.

d. No.

4. In two separate rate dockets (Docket Nos. R2009-3 and R2010-3), the Postal Service requested authority to conduct short-term "summer sales." Included among the justifications for the proposed short-term price reductions were assertions by the Postal Service that it then had excess capacity.

a. Does the Postal Service still consider itself to have excess capacity? If not, has all previous excess capacity referred to in those prior dockets now been effectively eliminated? Please explain as necessary.
b. If the Postal Service no longer considers itself to have excess capacity, approximately when — *i.e.,* in what year and what quarter of that year — did excess capacity cease to exist as a serious operating consideration?
c. If the Postal Service now has excess capacity in its career labor force, please explain why, under such circumstances, the Postal Service would add any new employees, regardless of whether those new employees are classified as career or non-career.
d. Does the Postal Service now have sufficient flexibility with respect to its labor force to adjust to mail volume changes of the magnitude shown in Attachment 15, most especially the 4.1 billion decline in volume from the 2013 Forecast to the 2014 AR Forecast (Jan 26, 2014)? If not, please describe all rigidities, inflexibilities, or other obstacles that prevent prudent management from making appropriate cost-saving adjustments.

RESPONSE:

a.-b. In Docket No. R2009-3, the Postal Service identified expected excess capacity in the summer of 2009 in buildings, equipment, vehicles, city and rural delivery, and postmasters, due to seasonal and cyclical volume declines. In Docket No. R2010-3, the Postal Service identified expected excess capacity for the FY 2010 Summer Sale in buildings, equipment, vehicles, and postmasters, but not in the delivery network, as the steep volume declines experienced from 2007 to 2009 were anticipated to abate. Excess capacity must be evaluated in the context of the existing service standards and networks Under existing service standards, and with the current networks, the Postal Service has eliminated the level of excess capacity that motivated the Summer Sales, but may have some lingering capacity issues in buildings, equipment, and postmasters. But, as indicated by the reduced scope of the identified excess capacity anticipated in the summer of 2010 in Docket No. R2010-3, by that time systemwide excess capacity was substantially diminished as a "serious operating consideration," outside the scope of efforts to re-evaluate service standards and network changes. Of course, as explained in the response to part c. below, on a local basis, there are still likely to be some pockets of apparent excess capacity, which the Postal Service seeks to address on a continual basis.

c. Excess labor capacity exists when there is mismatch between available labor and the workload associated with the mail presented for acceptance, transportation, processing, and delivery. Mail volumes originate and destinate across the country, but labor resources are, to a large extent, necessarily local. Therefore, excess capacity may exist on a local basis in some places in the system, but not necessarily in all places. In high-growth areas, for example, it may be necessary to add employees even though in other parts of the system there could be pockets of excess capacity. This question assumes a much less dynamic set of circumstances than those actually faced by an entity as large and complex as the postal service.

d. A volume loss of 4.1 billion pieces from FY2013 to FY2014(AR) represents a decline of about 2.6 percent, which is also the average annual rate of decline since FY2010. In contrast with the situation from FY2007 to FY2010, when volume declines averaged 7 percent on an annual basis, the Postal Service is of the view that ongoing attrition will be sufficient for the labor force to adjust to mail volume changes in 2014 of the magnitude shown in Attachment 15 to the Nickerson Statement. That, of course, is not to say that there are no obstacles that prevent management from making appropriate cost-saving adjustments, with the most obvious example being the current impasse on moving to 5-day delivery.

5. At page 4, lines 4-8 of Mr. Nickerson's Statement, he states:

> [T]he Postal Service made numerous cost reductions in response to the revenue loss, which have allowed it to maintain a minimal level of liquidity (excepting defaults on retiree health benefits (RHB) prefunding requirements). However, even as cost reductions are implemented, this level of liquidity is intolerably low and must, under prudent management, be increased.

a. A 2011 Postal Service Office of Inspector General (OIG) report estimated that the Postal Service could save hundreds of millions of dollars, perhaps even billions, annually by converting expensive residential door delivery to curbside delivery. *See* USPS OIG, Audit Report: Modes of Delivery, Report No. DR-AR-11-006 (July 7, 2011). Does the Postal Service currently have any plans that would convert existing residential and business door delivery to other less expensive modes?

b. Would the conversion of residential and business door delivery to curbside delivery or other less expensive modes be within the control of the Postal Service? If not, please explain why not. If so, please explain why the Postal Service has not taken the initiative to achieve such cost savings.

RESPONSE:

a. The Postal Service continues its longstanding practice of working with communities, business owners, landlords, and developers to implement voluntary delivery mode conversions. In 2012, the Postal Service revised its handbooks to enable the Postal Service to determine the delivery mode for new delivery points. At this time, the Postal Service is examining options for greater use of conversions for existing deliveries. The Postal Service's Five Year Business Plan (April 2013) includes limited expansion of deliveries to centralized boxes. These conversions would be voluntary in nature, with the exception of new deliveries.

b. Yes, it is within the Postal Service's legal authority to require conversions, upon revising its existing regulations which require customer consent for conversions. To the extent that a change in the nature of delivery service is at least substantially nationwide in scope, it would be subject to the requirement that the Postal Service request an advisory opinion from the Postal Regulatory Commission under section 3661. However, for a number of reasons, the Postal Service has thus far not considered it prudent at this time to adopt the OIG's recommendation that it "aggressively move from existing door-to-door delivery to curbside delivery." These reasons were enunciated in the Postal Service's response to the OIG report, and include the potential negative impact on volume that could occur, the impact on customers and communities, and the intensity of public and political resistance that would likely result. In addition, practical challenges which likewise would need to be fully considered include geographic inconsistencies with respect to community conditions and suitability for curbline, sidewalk, or centralized delivery; equipment costs associated with delivery conversion; and costs connected to a potential increase in eligibility for hardship delivery. In sum, door delivery is a service that customers value, and the Postal Service has been sensitive to those concerns and to the impacts that delivery conversion could have on mail volumes and the value of the mail.