REGULATORY UPDATE AND THE PRC’S ROLE IN REFORM

ASSOCIATION OF ALTERNATE POSTAL SYSTEMS
THE VISION AND VOICE OF PRIVATE ADVERTISING DISTRIBUTION

April 27, 2013

Mark D. Acton, Commissioner
Introduction

- Role of the Commission
- Recent Regulatory Activity
- Regulatory Issues Ahead
- Challenges in Current Environment, Reform
- Closing

The views expressed are those of the author alone, and do not necessarily reflect the views of the Postal Regulatory Commission.
Role of the Commission

The Commission fulfills three key roles

- Ensure the Postal Service complies with the law
- Provides transparency and accountability of the Postal Service
- Advise the Service on changes in service that are at least substantially nationwide in effect

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Role of the Commission

- In fulfilling its statutory roles of determining compliance, fostering transparency and accountability, and advising on large scale service changes:
- Stakeholder participation is key

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Recent Regulatory Activity - ACD

- On March 28 the Commission issued its Annual Compliance Determination (ACD) discussing:
  - Overall financial condition of the Postal Service
  - Standard flats cost coverage/pricing
  - Non-profit worksharing discounts
  - Periodicals costing and service issues
  - First-Class Mail elasticity and pricing

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Recent Regulatory Activity - ACD

Findings – Financial Performance

- Financial Performance
  - $15.9 billion loss in FY 2012
    - $11.1 billion Retiree Health Benefit Fund expense
    - $2.4 billion Workers’ Compensation Liability expense
    - $2.4 billion Loss Under Management Control
  - Sixteen workshare discounts exceeded costs
    - Directed to improve or explain in next rate adjustment

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Recent Regulatory Activity – ACD

Findings - Standard Flats

- In 2010 the Commission found that the prices in effect for Standard Mail Flats in FY 2010 did not comply with 39 U.S.C. 101(d).
  - Finding predicated on a series of previous regulatory concerns expressed in ACDs and annual rate adjustments.
  - There was a significant (and growing) cost coverage shortfall that persisted over a significant period, there was evidence that the shortfall was likely to increase further, and the Postal Service had failed to address the shortfall or take remedial steps.
  - Culminated in a direction to the Postal Service to increase Standard Mail Flats cost coverage through a combination of above-average price adjustments and cost reductions.

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Recent Regulatory Activity – ACD

Findings - Standard Flats

- Standard Mail Flats Cost Coverage and Losses

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Recent Regulatory Activity – ACD

Findings - Standard Flats

- FY 2012 Std Mail Volume & Contribution ($5.341b)
  - Letters, 58%
  - Flats, 7%
  - HD & Sat Letters, 7%
  - HD and Sat Flats and Parcels, 15%
  - Carrier Route, 11%
  - Parcels, 0%

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Recent Regulatory Activity – ACD

Findings - Standard Flats

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Recent Regulatory Activity – ACD

Findings - Standard Flats

- Postal Service began making progress on Standard Mail flats’ cost coverage
- No changes to the directive in the FY 2010 ACD are necessary
- Postal Service should continue with its three-year plan of cost reductions and rate increases

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Recent Regulatory Activity - ACD

Findings - Non-profit

- Non-profit workshare discounts in the FY 2012 ACD
  - Comments received from the Alliance of Nonprofit Mailers concerning differential between regular worksharing and nonprofit worksharing discounts
  - The Commission found that the discounts varied (in FY 2012) without explanation or justification from the Postal Service.
  - Settlement between ANM and the USPS

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## Recent Regulatory Activity - ACD

### Findings - Periodicals

**Volume, Revenue, Cost, and Coverage**

<table>
<thead>
<tr>
<th>Periodicals FY 2012 Financial Results</th>
<th>Volume</th>
<th>Revenue</th>
<th>Cost</th>
<th>Cost Coverage</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Within County</strong></td>
<td>631,286,455</td>
<td>$66,495,595</td>
<td>$95,398,328</td>
<td>69.70%</td>
</tr>
<tr>
<td><strong>Outside County</strong></td>
<td>6,110,064,496</td>
<td>$1,656,732,110</td>
<td>$2,306,203,681</td>
<td>71.84%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>6,741,350,951</td>
<td>$1,731,485,915</td>
<td>$2,401,602,009</td>
<td>72.10%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Periodicals FY 2011 Financial Results</th>
<th>Volume</th>
<th>Revenue</th>
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<th>Cost Coverage</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Within County</strong></td>
<td>661,561,122</td>
<td>$69,180,835</td>
<td>$89,249,728</td>
<td>77.51%</td>
</tr>
<tr>
<td><strong>Outside County</strong></td>
<td>6,415,178,344</td>
<td>$1,743,551,087</td>
<td>$2,340,773,780</td>
<td>74.49%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>7,076,739,466</td>
<td>$1,821,135,901</td>
<td>$2,430,023,509</td>
<td>74.94%</td>
</tr>
</tbody>
</table>

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Recent Regulatory Activity - ACD

Findings - Periodicals

- Service Performance (% on time)

<table>
<thead>
<tr>
<th>On-Time Service Performance (%) FY 2012</th>
<th>Quarter 1</th>
<th>Quarter 2</th>
<th>Quarter 3</th>
<th>Quarter 4</th>
<th>Annual</th>
<th>Target</th>
</tr>
</thead>
<tbody>
<tr>
<td>Destination Entry Outside County</td>
<td>46.3</td>
<td>66.9</td>
<td>83.1</td>
<td>84.6</td>
<td>69.8</td>
<td>91</td>
</tr>
<tr>
<td>End-to-End Outside County</td>
<td>43.3</td>
<td>57.9</td>
<td>74.3</td>
<td>66.6</td>
<td>59.9</td>
<td>91</td>
</tr>
<tr>
<td>Within County</td>
<td>45.9</td>
<td>65.8</td>
<td>82.1</td>
<td>82.6</td>
<td>68.7</td>
<td>91</td>
</tr>
<tr>
<td>Overall</td>
<td>45.9</td>
<td>65.8</td>
<td>82.1</td>
<td>82.6</td>
<td>68.7</td>
<td>91</td>
</tr>
</tbody>
</table>

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<td>77.8</td>
<td>74.3</td>
<td>77</td>
<td>77</td>
<td>91</td>
</tr>
<tr>
<td>End-to-End Outside County</td>
<td>69.2</td>
<td>70.1</td>
<td>65.4</td>
<td>69.9</td>
<td>69.9</td>
<td>91</td>
</tr>
<tr>
<td>Within County</td>
<td>77.9</td>
<td>76.2</td>
<td>72.4</td>
<td>75.5</td>
<td>75.5</td>
<td>91</td>
</tr>
<tr>
<td>Overall</td>
<td>76.7</td>
<td>77.9</td>
<td>76.2</td>
<td>72.4</td>
<td>75.5</td>
<td>91</td>
</tr>
</tbody>
</table>

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## Recent Regulatory Activity - ACD

### Findings - Periodicals

- **Historical financial results (millions)**

<table>
<thead>
<tr>
<th>Year</th>
<th>Volume</th>
<th>Revenue</th>
<th>Cost</th>
<th>Cost Coverage</th>
<th>Contribution</th>
</tr>
</thead>
<tbody>
<tr>
<td>2007</td>
<td>8,795</td>
<td>$2,188</td>
<td>$2,636</td>
<td>83.01%</td>
<td>$(448)</td>
</tr>
<tr>
<td>2008</td>
<td>8,605</td>
<td>$2,295</td>
<td>$2,732</td>
<td>84.00%</td>
<td>$(437)</td>
</tr>
<tr>
<td>2009</td>
<td>7,953</td>
<td>$2,038</td>
<td>$2,680</td>
<td>76.04%</td>
<td>$(642)</td>
</tr>
<tr>
<td>2010</td>
<td>7,269</td>
<td>$1,879</td>
<td>$2,490</td>
<td>75.46%</td>
<td>$(611)</td>
</tr>
<tr>
<td>2011</td>
<td>7,077</td>
<td>$1,821</td>
<td>$2,430</td>
<td>74.94%</td>
<td>$(609)</td>
</tr>
<tr>
<td>2012</td>
<td>6,741</td>
<td>$1,732</td>
<td>$2,402</td>
<td>72.10%</td>
<td>$(670)</td>
</tr>
</tbody>
</table>

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Recent Regulatory Activity - ACD

Findings - Periodicals

- Historical Financial Results (unit basis)

<table>
<thead>
<tr>
<th>Year</th>
<th>Cost/Pc</th>
<th>Revenue/Pc</th>
<th>Contribution/ Piece</th>
</tr>
</thead>
<tbody>
<tr>
<td>2007</td>
<td>$0.300</td>
<td>$0.249</td>
<td>$(0.051)</td>
</tr>
<tr>
<td>2008</td>
<td>$0.318</td>
<td>$0.267</td>
<td>$(0.051)</td>
</tr>
<tr>
<td>2009</td>
<td>$0.337</td>
<td>$0.256</td>
<td>$(0.081)</td>
</tr>
<tr>
<td>2010</td>
<td>$0.343</td>
<td>$0.258</td>
<td>$(0.084)</td>
</tr>
<tr>
<td>2011</td>
<td>$0.343</td>
<td>$0.257</td>
<td>$(0.086)</td>
</tr>
<tr>
<td>2012</td>
<td>$0.356</td>
<td>$0.257</td>
<td>$(0.099)</td>
</tr>
</tbody>
</table>

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## Historical Financial Results (unit basis)

<table>
<thead>
<tr>
<th></th>
<th>Plant Man</th>
<th>NONMods</th>
<th>Plant Mech</th>
<th>Bundle</th>
<th>Plant Allied</th>
<th>Other Allied</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Periodicals OC Flats</td>
<td>1.47</td>
<td>0.92</td>
<td>1.10</td>
<td>1.02</td>
<td>1.26</td>
<td>1.19</td>
<td>1.20</td>
</tr>
<tr>
<td>Mail Processing</td>
<td>4.42</td>
<td>4.73</td>
<td>5.19</td>
<td>5.74</td>
<td>5.10</td>
<td>4.71</td>
<td>4.89</td>
</tr>
<tr>
<td>Cost 1999 - 2012</td>
<td>1.94</td>
<td>3.33</td>
<td>3.55</td>
<td>3.34</td>
<td>3.74</td>
<td>4.80</td>
<td>5.22</td>
</tr>
<tr>
<td>Percent Change</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>FY99 to FY12</td>
<td>-18%</td>
<td>10%</td>
<td>169%</td>
<td>-18%</td>
<td>-7%</td>
<td>217%</td>
<td>53%</td>
</tr>
</tbody>
</table>

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Recent Regulatory Activity - ACD

Findings - Periodicals

- Directed the Postal Service to review its operational strategy to assess what cost savings measures are working, and how they could be improved.
- Encouraged the Postal Service to evaluate whether it can change workshare discounts and pricing structure to reverse the negative trend.

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Recent Regulatory Activity – ACD

Findings - First-Class Mail

First-Class Mail Presort Coverage and Passthrough

- FCM Presort Cost Coverage is 292%
- The 5-digit Workshare discount passthrough was 77.4%

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Recent Regulatory Activity – ACD

Negotiated Service Agreements

- Competitive NSAs continue to show significant growth for postal revenues
- Market dominant NSAs are more challenging, to review and to evaluate

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Recent Regulatory Activity – ACD

Competitive Negotiated Service Agreements

- 355 Competitive NSAs approved since the PAEA
  - Competitive NSAs required to cover attributable cost
  - Collectively, competitive products must contribute to institutional costs of the Postal Service (currently 5.5%)

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Recent Regulatory Activity – ACD

Market Dominant Negotiated Service Agreements

- 17 Market Dominant NSAs reviewed since 2009
  
  Each Market Dominant NSA must be available on public and reasonably terms to similarly situated mailers and either
  
  - improve the net financial position of the Postal Service
    - Reduce costs; or
    - Increasing overall contribution
  
  - or Enhance the performance of mail preparation, processing, transportation, or other functions

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Regulatory Issues Ahead

Future Innovations

- As pressures continue to mount:
  - Pressure to reduce costs (e.g. 5-day delivery)
  - Pressure to increase revenue (e.g. competing in existing markets, Valasis NSA)
  - Pressure to drive productivity (e.g. increased worksharing)

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Regulatory Issues Ahead

Delivery Frequency

- The Postmaster General announced the Postal Service’s intention to move to 5-day mail delivery and 6-day package delivery
  - Revised proposal is to address concerns:
    - Growth in parcel market
    - Reliance on parcels for prescription drug delivery
- In light of Appropriations bill language, the Board of Governors’ issued an April 10th Press release to postpone implementation
- 2010 Advisory Opinion methodology with updated costs: $1.744 billion in annual savings
- Access to the mailbox:
  - Commission recommended newspapers have access to the mailbox
  - If new request filed, similar recommendation for periodicals/flats could be considered

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Regulatory Issues Ahead
Challenges and Opportunities

- **Challenge:** maintaining solvency in light of volume declines
  - Volume falling faster than the Postal Service can pull costs out of the system

- **Opportunities:**
  - Piggybacking on the 5-day mail delivery proposal: Dynamic routing
    - New delivery paradigm for the Postal Service, shifts focus to efficient routing similar to its competitors
  - Drive efficiency by sending the right signals through workshare discounts to incentivize “cheap” mail
  - Focus on the core competencies of the organization

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Regulatory Issues Ahead

Procedures for Nature of Service Cases Docket RM2012-4

- Commission instituted a rulemaking to revise procedures for Nature of Service (Advisory Opinion) cases
  - Law requires a “hearing on the record”
  - Streamlining process to the extent due process allows

- Next Steps: Proposed Rules

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Regulatory Issues Ahead

Review of the PAEA and Ratemaking

- The 2006 law tasked the Commission with reviewing the Postal Accountability and Enhancement Act, including its modern system of ratemaking, 10 years after implementation.

- 39 U.S.C. 3622(d)(3) provides that the Commission must evaluate if the system is achieving the objectives of the section, while taking into account the factors.
  - If the Commission determines the system is not achieving the objectives while taking into account the factors, it may, after a notice and comment procedure and by regulation, establish a new system as necessary.

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Regulatory Issues Ahead
Review of the PAEA and Ratemaking

- Price cap
  - Effective in spurring cost reductions
  - Effective at constraining price increases
  - Challenging to maintain adequate revenues

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Regulatory Issues Ahead

Review of the PAEA and Ratemaking

Effective in spurring cost reductions

Six Years Prior to PAEA (FY 2000 - FY 2006)

Six Years After PAEA (FY 2007 - FY 2012)

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Regulatory Issues Ahead
Review of the PAEA and Ratemaking

Effective at constraining price increases

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Regulatory Issues Ahead
Review of the PAEA and Ratemaking

Challenging to maintain adequate revenues

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Regulatory Issues Ahead

Review of the PAEA and Ratemaking

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Challenges and Reform

Action Items

- The Commission brings a unique perspective to postal reform – independent of the Postal Service
  - Consider the “on the record” requirement for hearings in Nature of Service (Advisory Opinion) cases
  - Maintain prospective review for changes in the nature of postal services and competitive NSAs
  - Raise the market test revenue cap for Market Dominant products to allow for meaningful market tests
  - Re-amortize the current mandated payments into the Postal Service Retiree Health Benefit Fund (PSRHBF)

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Challenges and Reform

Options on the Table

- Post-PAEA Nature of Service Review

<table>
<thead>
<tr>
<th>Proposed Change</th>
<th>Approx. Annual Savings ($Billions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Saturday Delivery</td>
<td>$1.744 (PRC Estimate: N2010-1)</td>
</tr>
<tr>
<td>Mail Processing Realignment</td>
<td>$.45 - 1.96 (PRC Estimate N2012-1)</td>
</tr>
<tr>
<td>POStPlan</td>
<td>$.39 - .70 (PRC Estimate N2012-2)</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$2.84 – 4.40</strong></td>
</tr>
</tbody>
</table>

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Closing

- Role of Commission moving forward
- The Universal Service Obligation

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