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# *REGULATORY UPDATE AND THE PRC'S ROLE IN REFORM*

*CENTER FOR RESEARCH IN REGULATED INDUSTRIES: POSTAL REORGANIZATION*

April 12, 2013

Mark D. Acton, Commissioner

# Introduction

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

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# Role of the Commission

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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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# Recent Regulatory Activity -ACD

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- 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*

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- 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*

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- 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

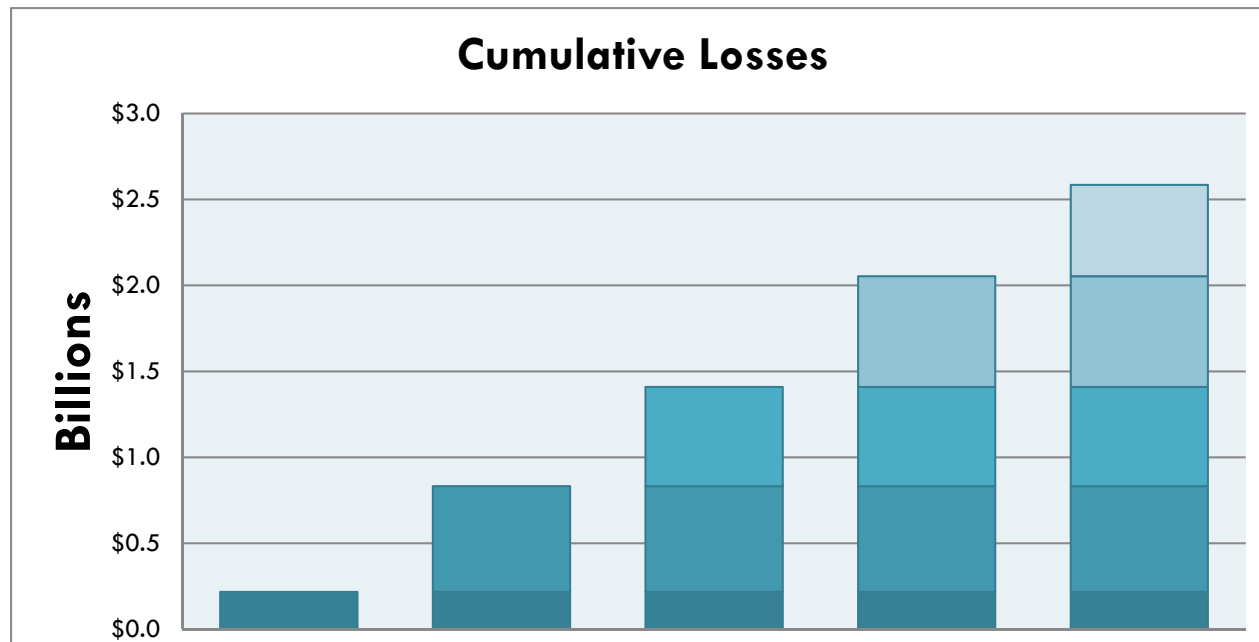
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# Recent Regulatory Activity – ACD

## Findings - Standard Flats

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### □ Standard Mail Flats Cost Coverage and Losses



FY	2008	2009	2010	2011	2012
Cost Coverage	94.4%	82.4%	81.8%	79.5%	80.7%

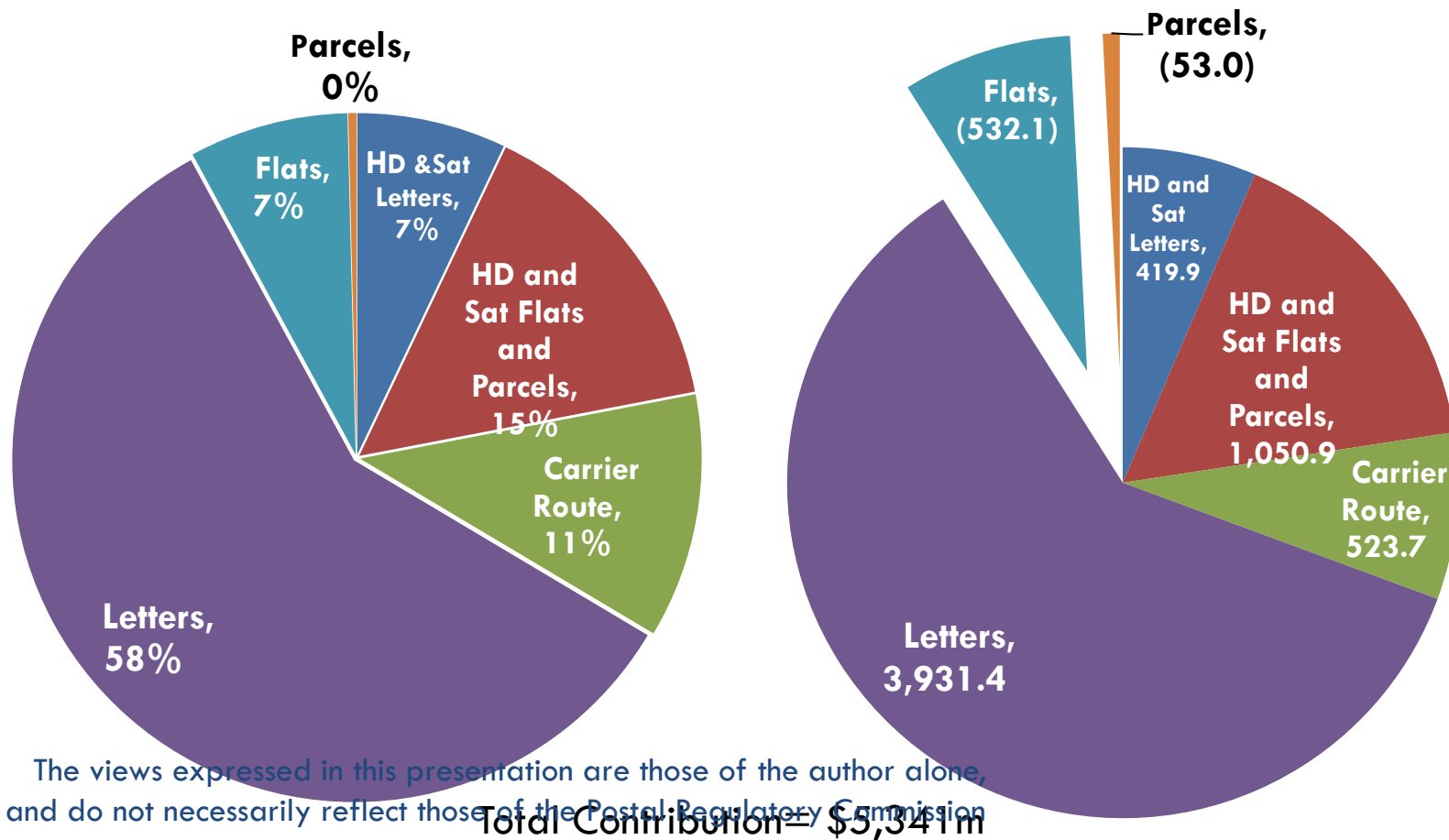
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# Recent Regulatory Activity – ACD

## Findings - Standard Flats

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- FY 2012 Std Mail Volume & Contribution (\$5.341 b)



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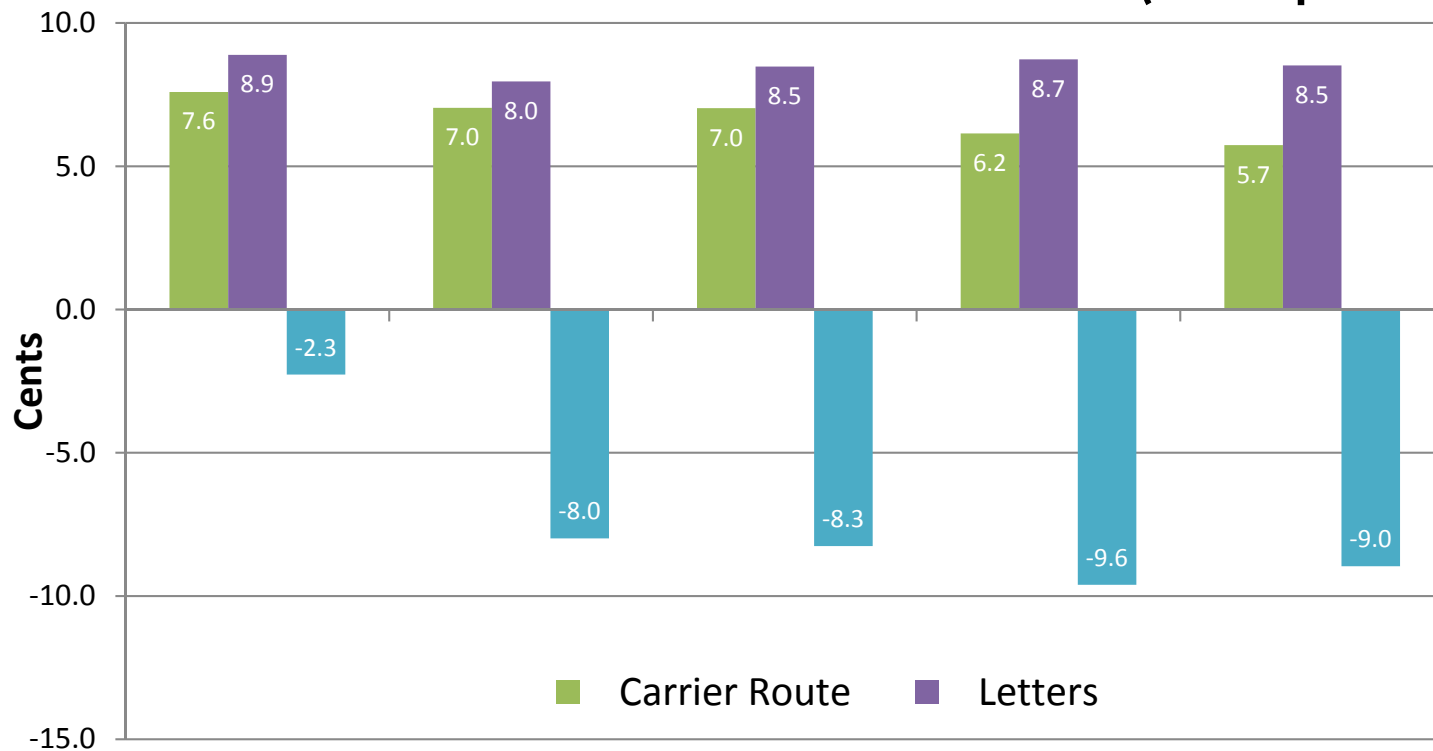


# Recent Regulatory Activity – ACD

## Findings - Standard Flats

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### Standard Mail Flats Unit Contribution (Comparison)



Contribution Gap	2008	2009	2010	2011	2012
Carrier Route - Flats	9.9	15.0	15.3	15.8	14.7
Letters - Flats	11.2	16.0	16.7	18.3	17.5

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# Recent Regulatory Activity – ACD

## *Findings - Standard Flats*

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- 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*

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- 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

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### □ Volume, Revenue, Cost, and Coverage

Periodicals FY 2012 Financial Results				
	Volume	Revenue	Cost	Cost Coverage
<b>Within County</b>	631,286,455	\$ 66,495,595	\$ 95,398,328	69.70%
<b>Outside County</b>	6,110,064,496	\$ 1,656,732,110	\$ 2,306,203,681	71.84%
<b>Total</b>	6,741,350,951	\$ 1,731,485,915	\$ 2,401,602,009	<b>72.10%</b>
Periodicals FY 2011 Financial Results				
	Volume	Revenue	Cost	Cost Coverage
<b>Within County</b>	661,561,122	\$ 69,180,835	\$ 89,249,728	77.51%
<b>Outside County</b>	6,415,178,344	\$ 1,743,551,087	\$ 2,340,773,780	74.49%
<b>Total</b>	7,076,739,466	\$ 1,821,135,301	\$ 2,430,023,509	<b>74.94%</b>

72.10%

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# Recent Regulatory Activity - ACD

## Findings - Periodicals

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### □ Service Performance (% on time)

**Compare**

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

On-Time Service Performance (%) FY 2011	Quarter 1	Quarter 2	Quarter 3	Quarter 4	Annual	Target
Destination Entry Outside County		78.7	77.8	74.3	77	91
End-to-End Outside County		69.2	70.1	65.4	69.9	91
Within County		77.9	76.2	72.4	75.5	91
Overall	76.7	77.9	76.2	72.4	75.5	91

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# Recent Regulatory Activity - ACD

## Findings - Periodicals

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### □ Historical financial results (millions)

<u>Historical Financial Results (Millions)</u>					
<u>Year</u>	<u>Volume</u>	<u>Revenue</u>	<u>Cost</u>	<u>Cost Coverage</u>	<u>Contribution</u>
2007	8,795	\$ 2,188	\$ 2,636	83.01%	\$ (448)
2008	8,605	\$ 2,295	\$ 2,732	84.00%	\$ (437)
2009	7,953	\$ 2,038	\$ 2,680	76.04%	\$ (642)
2010	7,269	\$ 1,879	\$ 2,490	75.46%	\$ (611)
2011	7,077	\$ 1,821	\$ 2,430	74.94%	\$ (609)
2012	6,741	\$ 1,732	\$ 2,402	72.10%	\$ (670)
					\$ (3,417)



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# Recent Regulatory Activity - ACD

## Findings - Periodicals

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### □ Historical Financial Results (unit basis)

	<u>Cost/Pc</u>	<u>Revenue/ Pc</u>	<u>Contribution/ Piece</u>
<b>2007</b>	\$ 0.300	\$ 0.249	\$ (0.051)
<b>2008</b>	\$ 0.318	\$ 0.267	\$ (0.051)
<b>2009</b>	\$ 0.337	\$ 0.256	\$ (0.081)
<b>2010</b>	\$ 0.343	\$ 0.258	\$ (0.084)
<b>2011</b>	\$ 0.343	\$ 0.257	\$ (0.086)
<b>2012</b>	\$ 0.356	\$ 0.257	\$ (0.099)



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# Recent Regulatory Activity - ACD

## Findings - Periodicals

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### □ Historical Financial Results (unit basis)

Periodicals OC Flats Mail Processing Cost 1999 - 2012									Percent Change	
	<u>1999</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>2012</u>	<u>1999 to 2012</u>	<u>2007 to 2012</u>
Plant Man	1.47	0.92	1.10	1.02	1.26	1.19	1.20	1.21	-18%	10%
NONMods	3.36	4.42	4.73	5.19	5.74	5.10	4.71	4.89	46%	3%
Plant Mech	1.94	3.33	3.55	3.34	3.67	3.48	4.80	5.22	169%	47%
Bundle	3.00	2.68	2.74	2.76	2.71	2.60	2.51	2.45	-18%	-10%
Plant Allied	2.70	4.15	4.62	4.54	4.54	4.34	4.10	4.30	59%	-7%
Other Allied	0.58	1.03	1.11	1.63	1.68	1.91	1.81	1.83	217%	65%
<b>Total</b>	13.05	16.52	17.83	18.48	19.60	18.62	19.12	19.92	53%	12%

	Periodicals CRA Unit Cost	Mail Processing	Delivery	Contract Transportation	Other
<b>FY10</b>	34.25	18.62	12.24	3.25	0.14
<b>FY11</b>	34.34	19.12	11.97	3.09	0.16
<b>FY12</b>	35.62	19.92	12.06	3.53	0.12
<b>Cumulative Change</b>					
	1.37	1.29	(0.18)	0.28	(0.02)
	4.0%	6.9%	-1.5%	8.7%	-15.2%

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# Recent Regulatory Activity - ACD

## *Findings - Periodicals*

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- 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*

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### First-Class Mail Presort Coverage and Passthrough

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

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# Recent Regulatory Activity – ACD

## *Negotiated Service Agreements*

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- 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*

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- 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*

21

- 17 Market Dominant NSAs reviewed since 2009
  - ▣ Each Market Dominant NSA must be available on public and reasonable 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

## *Delivery Frequency*

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- 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
  - ▣ Claims authority to move forward under a Continuing Resolution
- In light of Appropriations bill language, the Board of Governors issued an April 10<sup>th</sup> Press release to postpone implementation
- 2010 Advisory Opinion methodology with updated costs: \$1.744 billion in annual savings
- Annual Report "cost of the USO" for 6-day delivery estimated at \$2.480 billion for FY 2011 (no revenue loss)

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# Regulatory Issues Ahead

*Procedures for Nature of Service Cases Docket RM2012-4*

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- 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*

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- 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*

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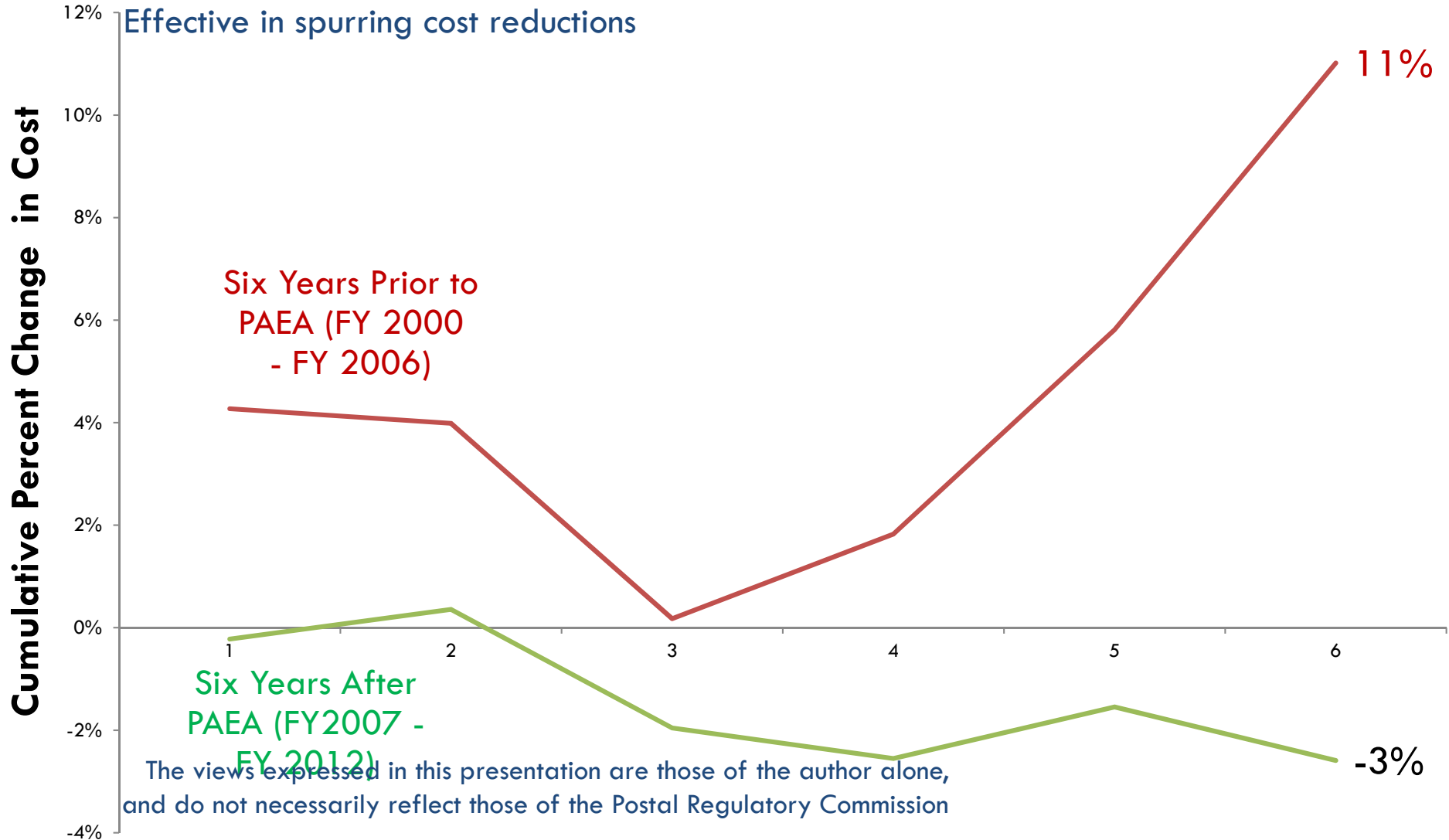
- Price cap
  - ▣ Effective in spurring cost reductions
  - ▣ Effective at constraining price increases
  - ▣ Challenge to maintain adequate revenues

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# Regulatory Issues Ahead

## Review of the PAEA and Ratemaking

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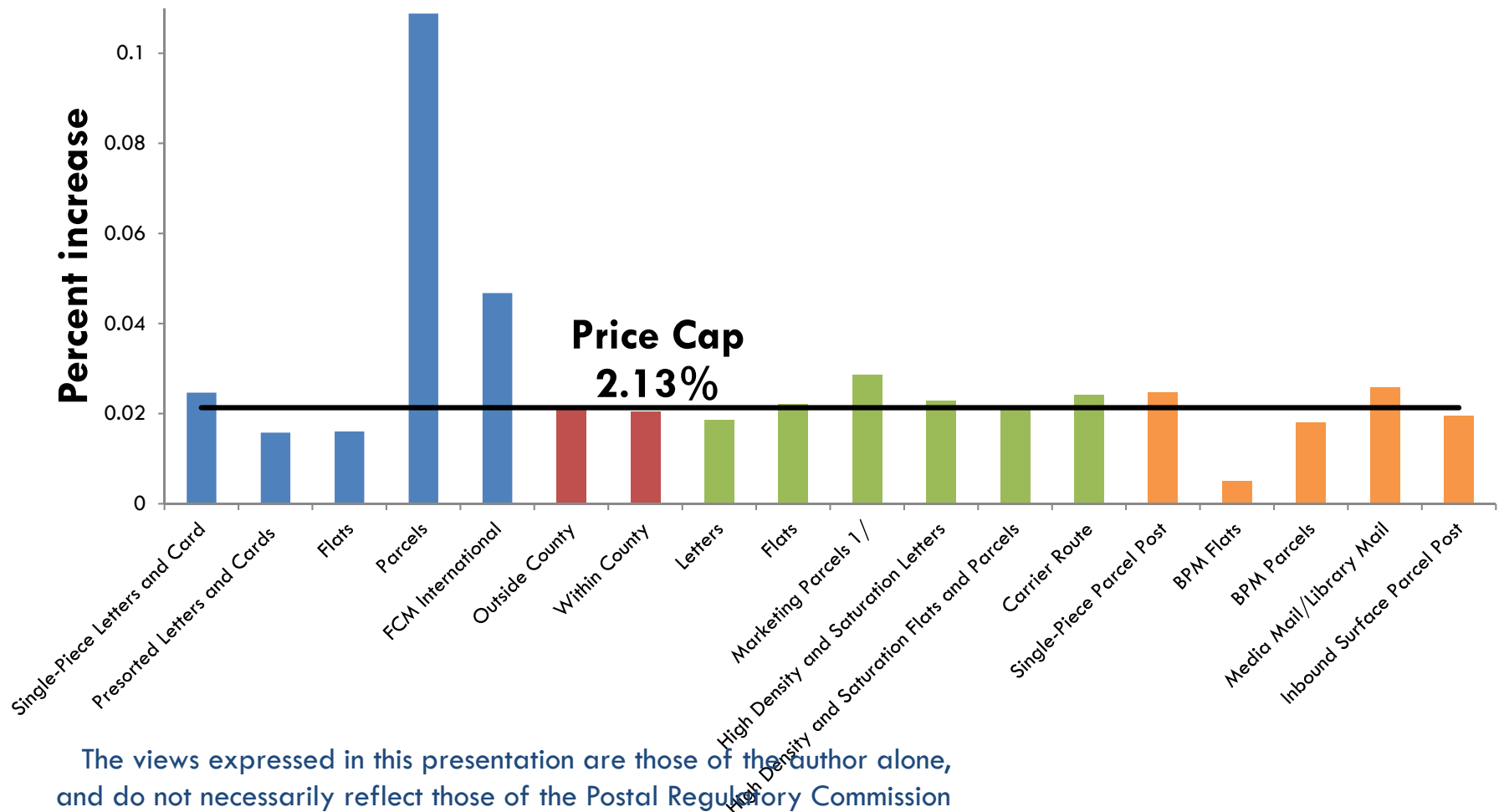


# Regulatory Issues Ahead

## Review of the PAEA and Ratemaking

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Effective at constraining price increases

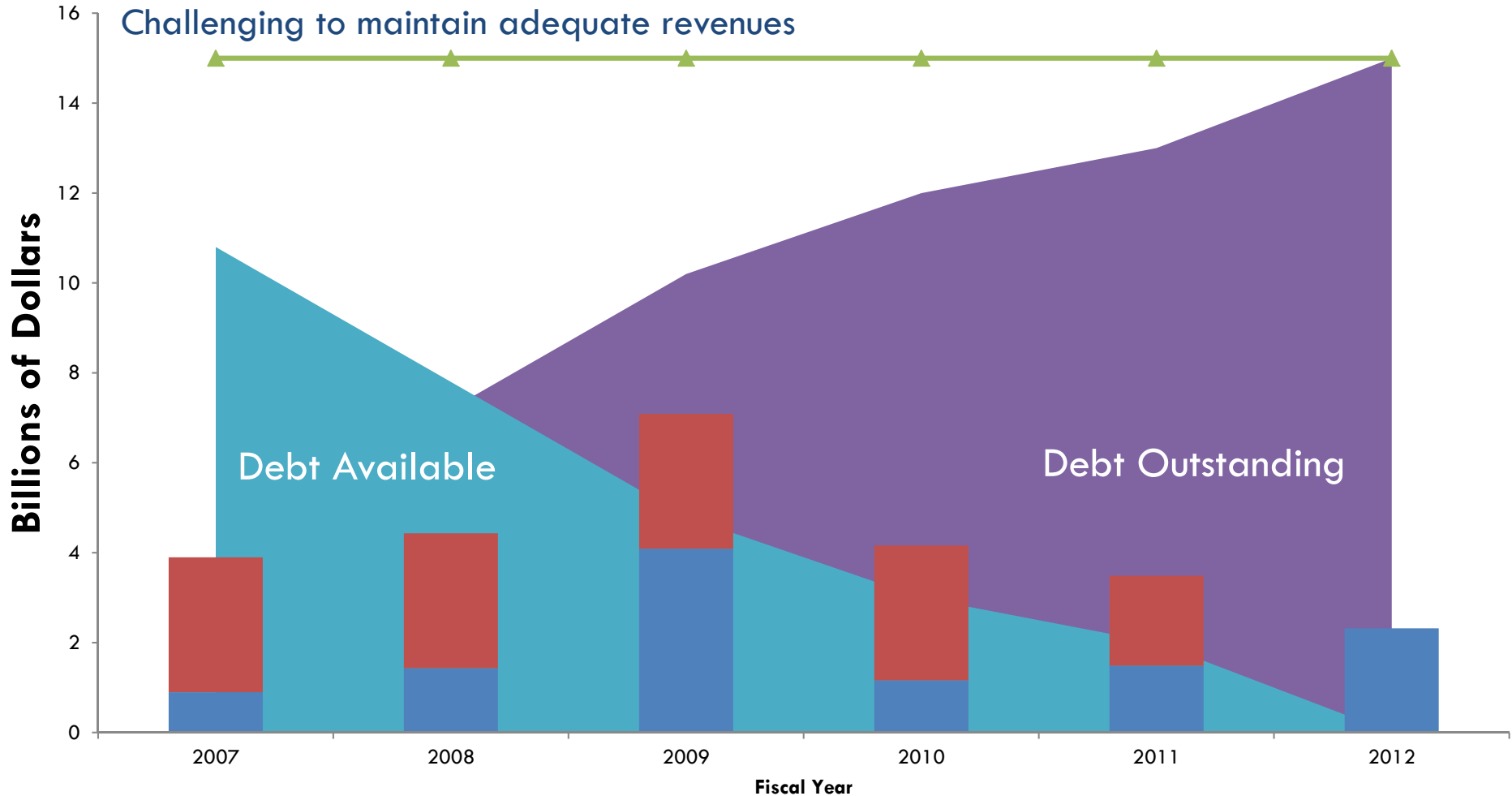


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# Regulatory Issues Ahead

## Review of the PAEA and Ratemaking

28



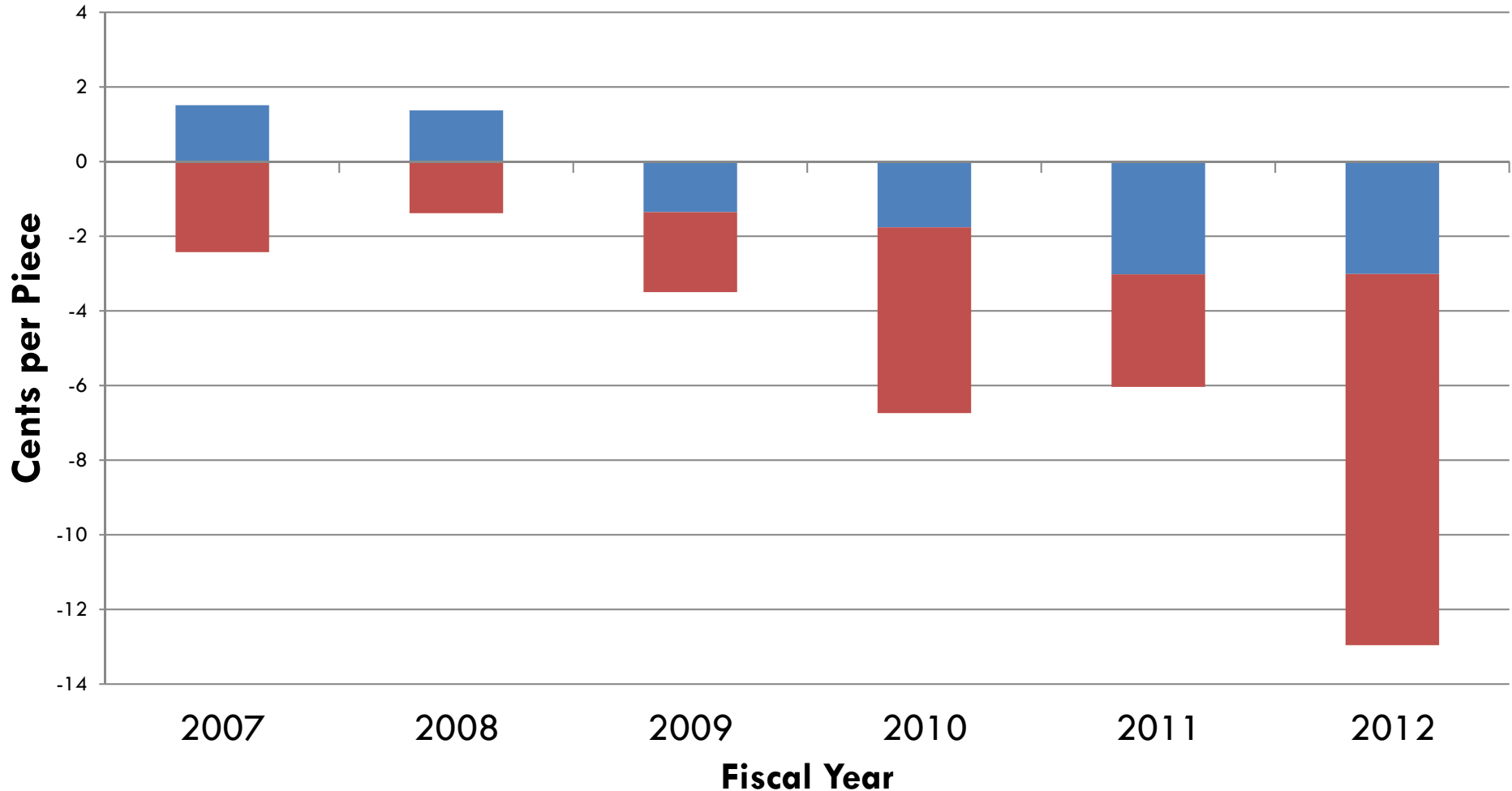
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■ Cash Balance EOY    ■ Annual Borrowing Limit    ▲ Debt Limit

# Regulatory Issues Ahead

## Review of the PAEA and Ratemaking

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■ Net Revenue per Piece w/o RHBF ■ Net Revenue Per Piece with RHBF

# Challenges and Reform

## *Commission Action Items*

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- ❑ 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*

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### □ Post-PAEA Nature of Service Review

Proposed Change	Approx. Annual Savings (\$Billions)
Saturday Delivery	<b>\$1.744</b> (PRC Estimate: N2010-1)
Mail Processing Realignment	<b>\$.45 - 1.96</b> (PRC Estimate N2012-1)
POStPlan	<b>\$.39 - .70</b> (PRC Estimate N2012-2)
<b><u>Total</u></b>	<b><u>\$2.84 – 4.40</u></b>

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# Closing

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- Role of Commission moving forward
- The Universal Service Obligation

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