

United States Senate
Committee on Government Affairs
Testimony of George Omas
Chairman, Postal Rate Commission
April 7, 2004

Chairman Collins, members of the Committee, thank you for providing me with the opportunity to testify on ways to achieve meaningful postal reform. The Committee has already heard from a number of thoughtful witnesses about the need to modernize the structure of the Postal Service to foster best management practices and more efficient and economical operations.

I agree that postal reform is necessary. Furthermore, I think that the five principles for postal reform outlined by the Administration, following receipt of the Report of the President's Commission on the Postal Service, provide a sound policy foundation for effective reform.

I believe that the two pieces of postal reform legislation drafted in the last Congress, S. 1285 and H.R. 4970, were for the most part consistent with those five principles. I suggest that they provide a good basis for developing an effective vehicle for achieving real reform.

My testimony today will focus on how those earlier efforts can be clarified and improved to be even more consistent with the Administration's five principles. I will also mention several ways to improve on suggestions made by the President's Commission on the Postal Service where they vary from the model developed in those earlier bills and are unlikely to foster results consistent with the Administration's principles. I will restrict my testimony to areas where, as Chairman of the Postal Rate Commission, I have developed first-hand expertise.

First, I will address the need for, and best ways to achieve, reliable and timely public information on Postal Service costs and operational performance. Next I will address the ability of a modern system of ratemaking to provide adequate public protection while affording management the flexibility to easily and quickly adjust rates as circumstances and customers needs require. I will touch briefly on areas where the authority of the regulator should be clarified, and conclude with some thoughts about how the regulator should be structured to facilitate collegial decision-making.

THE NEED FOR RELIABLE, PUBLIC INFORMATION ON POSTAL SERVICE COSTS AND OPERATIONS

As many in the postal community well know, the Postal Service's longstanding preference for limiting the circumstances in which data and information will be disclosed has been a perennial source of frustration in regulatory proceedings. At the very least, this stance has been problematic. At worst, it has been extremely detrimental to the public interest. I therefore applaud the fact that the Administration has unequivocally identified enhanced transparency as one of five fundamental postal reform principles. Legislation that incorporates this principle holds out the promise of an end to the tug-of-war over disclosure that has marked much of the reorganization era. More importantly, it provides the primary means to unlock the door to greater accountability. In fact, without a strong policy in favor of transparency, meaningful accountability cannot exist.

Transparency's elevated role under a revised business model has met with near-universal support among stakeholders. My tenure at the Commission convinces me that formal recognition of this policy is necessary, so I also support the proposal to make this a cornerstone of the revised business model. Much of the commentary on transparency tends to identify certain types of important financial or operational information that should be more available, but does not articulate an overarching standard or unifying principle. Fortunately, Treasury Secretary Snow's recent testimony provides a succinct standard for transparency that should be accepted as the basis for postal policies in this area.

Developing a working understanding of what transparency should mean in the postal context — and incorporating this understanding into legislative policies and directives — must be a priority if the spirit of the current reform effort is to survive after operations commence under the revised business model. The Postal Service has a long history of attempting to shield information on its activities from the public, and reform legislation must clearly enunciate that open access to Postal Service information is public policy. I believe Treasury Secretary Snow’s recent testimony captures the essence of what public policy should be. Specifically, he asserts that the scope of postal reform that is now envisioned requires transparency that is “true and exacting” and that dispenses with the claim that private sector confidentiality concerns apply to the Postal Service.

Openness, access, and disclosure should be the standard, and it should be made clear that these are the principles the Postal Service and the regulator are to follow. Because of the importance of these principles, I propose that language be added to the basic policy provision of title 39 to make it absolutely clear that transparency and accountability are essential aspects of postal activities. I propose that the following subsection be added to current section 101:

“(d) as a publicly-owned commercial enterprise that provides both market-dominant and competitive services, the Postal Service shall be subject to a high degree of transparency to ensure fair treatment of customers of the Postal Service’s market-dominant products and companies competing with the Postal Service’s competitive products.”

The Critical Relationship between Transparency and Accountability

Recently the Postal Service has responded to calls for improved transparency by undertaking to release some types of financial information that publicly traded private companies routinely publish. While I agree that SEC-style reporting is an improvement, other important factors also deserve more consideration. Reform proposals must ensure that the current level of disclosure of postal costs and operations data is

enhanced. To do so, legislation must provide a means to obtain additional disclosure in areas other than financial performance.

The President's Commission recommends several responsibilities for the regulator to ensure accountability, including detailed periodic reports, an expanded complaint jurisdiction, and certain important policy determinations. To successfully accomplish these functions, the regulator must have broad access to information in a variety of significant areas, including for example, data to measure product cost development and service performance. The regulator also must have clear authority to determine the frequency of reports, the depth of reporting, and related matters. This is not only in keeping with the spirit of postal reform, it is an essential part of meaningful reform.

Previous efforts to develop reform legislation recognized the need to provide the regulator with authority to obtain needed information from the Postal Service. In particular, S. 1285 provides the regulator with the responsibility to evaluate postal performance and the means to obtain the data and information necessary to carry out that duty.

An equally important part of transparency is public access to information. Secretary Snow focuses on this when he emphasizes that private sector confidentiality claims should be inapplicable to a government monopoly.

The reform model under consideration expects to assure fair treatment and achieve accountability in large measure by allowing public complaints to be filed with the regulator. For example, it should be self-evident that mailers will be unable to file complaints that allege rates involve cross-subsidy if they do not have access to detailed cost data. Similarly, they will be unable to claim service degradation without periodic information on performance.

It should be acknowledged that the Postal Service already discloses considerable data and information at the Commission under the current business model. This occurs via several avenues, such as routine reporting requirements and through discovery in the course of various proceedings. It is undeniably important to add SEC-style reporting requirements; however, it may be more important to affirmatively ensure that other material continues to be provided and remains available to the public under the revised business model.

I have heard nothing in reform discussions so far indicating that the Congress, most stakeholders, or the general public want *less* information than is now available. In fact, they expect — and deserve — more accountability under a new business model. Indeed, if the regimen of omnibus rate cases is eliminated in favor of quick reviews by the regulator, prompt access to more detailed information will be essential.

This is the most important area where the language of S.1285 is deficient. S. 1285 considerably strengthens the regulator's authority to obtain information from the Postal Service, but it appears to considerably reduce the regulator's authority to share that information with the public.

Section 502 of S. 1285 authorizes the Postal Service to force the regulator to withhold from the public matter that it provides the Commission "at the request of the Commission in connection with any proceeding or other purpose under [title 5]" if that matter "contains information which is described in section 410(c) of [title 5] or exempt from public disclosure under [the Freedom of Information Act]." The Postal Service's authority to tie the regulator's hands in this regard is set forth in paragraphs (1) and (2) of section 502.

Information that the Postal Service can require be withheld from the public includes matter identified in section 410(c) of title 39. As recently interpreted by the Federal courts, section 410(c) encompasses all commercial information that other

providers of similar services normally withhold. Of course private providers of services do not normally publish detailed information about their costs or operations.

Under S. 1285, the only way to override the Postal Service's decisions that information must be publicly suppressed is found in paragraph (3) of section 502. There, the regulator is authorized to override the Postal Service designations of commercial information as privileged from disclosure, but only if the information was elicited by "discovery" undertaken "in connection with a proceeding" under title 5. If information was elicited from the Postal Service in this manner, the regulator is authorized to follow the procedures that Federal civil courts follow in deciding whether to disclose commercially sensitive information. That procedure is found in rule 26(c) of the Federal Rules of Civil Procedure. It authorizes the judicial authority (the regulator in this context) to balance the potential harm to the Postal Service from disclosure against the discovering party's need for the information to make its case.

If commercial information identified by the Postal Service as confidential was not elicited by discovery in connection with a "proceeding," the provisions of S. 1285, read literally, do not allow the regulator to ever disclose such information to the public, no matter how important it might be to evaluating the Postal Service's compliance with the statute.

The model for postal reform suggested by the President's Commission emphasizes the elimination of legalistic proceedings in which discovery plays an important role. Instead, it contemplates ready public access to timely, detailed cost and operations reports. Assuming reform legislation continues to call for transparency to substitute for time-consuming and expensive litigation, the language of S.1285, section 502 will have to be changed.

I propose a more straightforward disclosure provision that gives the regulator the same responsibility as judges in Federal civil litigation. The Postal Service could still request that particular information not be publicly disclosed. The regulator would then

balance the likelihood and amount of commercial harm that public disclosure would cause the Postal Service, against the need of the public to analyze and understand the Postal Service's financial condition and its operational performance. Like a judge applying Federal Rule 26(c), if the regulator concludes that particular information is commercially sensitive, it would have the discretion to fashion methods and degrees of protection of information that are appropriate to the circumstance, subject to review only by appropriate judicial authority.

This approach should be applied to all information requested by the regulator that the Postal Service identifies as commercially sensitive, whether the regulator requests it in connection with a "proceeding," the preparation of regulations, the preparation of reports, or performing any other of its statutory duties. I think this would serve well as a means for assuring the type of transparency needed for postal reform. It would also make clear that the regulator has primary responsibility for evaluating any claims of confidentiality.

Reform legislation should include as a basic postal policy a transparency standard that will inform and protect the public under the revised business model. Secretary Snow's phrasing — that transparency should be "true and exacting," with no application of private sector confidentiality concerns — provides a unifying principle. The Postal Service remains a government entity under proposed postal reform, and this status should carry with it a far greater responsibility for openness and disclosure than that imposed on private corporations.

ATTRIBUTION OF COSTS

Attributing costs to individual postal products is one of the most important responsibilities under both existing law and recently proposed legislation. It has also become a primary issue of concern in postal reform discussions. For example, it is one of the three issues Treasury Secretary Snow focused on in his testimony before the "Joint Senate-House Hearing on Principles for Meaningful Reform". Also, the

President's Commission report "strongly encourages the (proposed Regulatory) Board to make this issue a top priority in order to ensure the system is fair, adequately protects the postal market from the distorting effects of cross-subsidization, and ensures the Postal Service has real insight into the success and failure of its various products and services."

I agree wholeheartedly with the importance correctly attributing costs to postal products. It is appropriately the most heavily researched and litigated topic in postal ratemaking. Rates are the sum of attributable cost plus a percentage markup. Get attribution wrong and rates will be wrong.

Underestimating attributable costs will mean that Postal Service competitive products will compete unfairly, while overestimating them will mean that Postal Service competitive products may not be able to compete. Finally, if attributable costs are wrong, inter-class rate relationships within the monopoly will not properly reflect relative demand and other ratemaking factors that should be considered.

The importance of attributable costs flows directly from the current statutory requirement that rates for each product must cover attributable costs and provide a reasonable contribution to non-attributable (institutional or general overhead) costs. At present, what constitutes a reasonable contribution is driven by the numerous public policy factors of the Act. What determines attributable costs is the existence of a causal relationship between products and costs. The Supreme Court confirmed in 1982 that attributable costs "were all costs that could be identified, in the view of the expert Rate Commission, as causally linked to a class of Postal Service."

While extensive Commission time has been expended in developing current estimates of attributable costs, I agree with Secretary Snow and the President's Commission that greater effort must be expended to ensure that all the costs that can be attributed are attributed. Current analysis can and should be expanded, but this will require additional cost data and functional analysis from the Postal Service.

Past Postal Rate Commission decisions have frequently contained requests for additional data and analysis in specific areas. Sometimes these requests were honored but all too often they have been ignored. Under the existing statute the Commission does not have the authority to compel the Service to collect specific data or perform needed studies.

As previously discussed, I support the legislative language in S. 1285 that gives the regulator authority to direct the Postal Service to collect data and to conduct studies of its costs. This authority will result in the prompt exploration of areas where there may be opportunities to identify additional attributable costs.

I must caution however, that it would be inappropriate to set a target percentage for attributable costs. In questions following Secretary Snow's testimony, Undersecretary Roseboro stated his belief that non-attributable costs should be "south of ten percent." In other words, attributable costs should be more than 90 percent of total costs. In response to questioning by Congressman McHugh, Undersecretary Roseboro acknowledged that no study exists to support that assertion. He stated that it was just a belief based on experience with other businesses. To my knowledge, no participant in our rate proceedings, even those in direct competition with the Postal Service, has ever suggested that such a large percentage of postal costs could reasonably be attributed. A causal relationship needs to be established in fact before costs should be attributed. Experience transferred from other businesses is not an adequate basis for attribution.

What Are Attributable Costs?

The Postal Rate Commission separates accrued Postal Service costs into attributable and institutional. The attributable costs are those causally linked to a subclass or type of service based on analyses of Postal Service costs and operations. If a cost can be determined to be caused by a product it is attributed to that product; if

not, then it is considered a general overhead or institutional cost that will be covered by the “reasonable contribution” assigned to each product.

In the Opinion and Recommended Decision in Docket R2000-1, the Commission found 63 percent of Postal Service costs attributable to specific products. The percentage has decreased somewhat over the last several rate cases due to the impact of worksharing discounts. Worksharing discounts are based on avoided attributable costs. If all of the currently workshared mail was not handled by the private sector, then the Postal Service would incur approximately \$14.5 billion dollars in additional attributable costs. As worksharing continues to grow it will reduce Postal Service attributable costs and thus the percentage of total costs that are attributed. The costs that would be attributable without worksharing is not the concern, however. What is important is that the regulator have the means to examine all of the costs currently treated as institutional to assure Congress, the Postal Service, and the public that all costs that can be attributed, are attributed. I believe that there is room for improvement and would welcome the responsibility and authority to achieve it.

How Attributable Costs are Calculated

In fulfilling its responsibilities the Commission has relied principally on two indicia of causation, volume variability and exclusivity. Volume variable costs are those that would vary (all other things held equal) if the volume of mail varies. Volume variable costs constitute over 97 percent of attributable costs identified by the Commission. Exclusive costs are incurred solely for the benefit of one class or service, and would not be incurred but for the provision of that class or service. In those instances the causal link is self-evident. Thus, exclusive costs, or in postal parlance, product specific costs, are attributed to the relevant service regardless of whether they are volume variable. For example, the costs of advertisements for Priority Mail are attributed to Priority Mail.

Volume variable attributable costs are calculated through an examination of postal volumes, operations and costs for separate postal activities. Examples of

separately examined activities are different types of mail processing such as manually sorting letters, bar code sorting machines, cancellation operations, and package sorting.

If the costs of an operation vary in response to changes in the volume of mail going through that operation, the costs are said to be volume variable. To the extent that costs of an activity are volume variable they are attributed to the volumes of mail going through that operation. Once the exclusive and the volume variable attributable costs have been calculated for each of the distinct activities of the Postal Service, the results are summed to obtain total attributable costs.

For some activities, it is necessary to engage in highly refined analysis to calculate separate volume variable costs for each of the cost-driving characteristics of the mail being handled. For example, the attribution analysis for loading mail into a mailbox has to take into consideration that parcels take longer than flats to handle, and that flats take longer than letters. Special services, such as certified mail, use even more resources. Consequently, special studies must be conducted to capture the amount of time that the carrier spends loading mail composed of different shapes. Failure to do so would result in under-pricing parcel post products, and over-pricing letter shaped mail. It is also necessary to take into consideration the type of mail receptacle used. The point I wish to make is that the analysis becomes quite complex in an attempt to identify what product characteristics are driving costs.

In a multi-product firm such as the Postal Service, it can be extremely difficult to differentiate the cost of one product from another. Finding the volume variable costs of an activity is not sufficient. A necessary second step is to associate the volume variable costs with the appropriate category of mail. Parties in our rate cases argue to have as little as possible of an activity's attributable costs associated with their mail. Since overall attributable percentages are the focus of the current debate, I will not discuss the methods used to distribute attributable costs in a causally related manner except to mention that distribution must also be based on sound analyses and good data.

Product specific costs are much easier to distribute in that they come directly out of the accounting system when so booked. For example, if a contract is issued for advertising only Priority Mail, then the Commission considers it attributable.

It has been argued that expenses for some additional activities could be recorded in the accounting system by product. An often-cited example is the time expended by marketing personnel. If such an employee works with a Parcel Select customer for a discrete period of time, then the accounting system could be improved to capture that time so that its cost could be attributed. These are costs that an effective regulator should be able to direct an operator to capture.

Where Are the Non-Attributed Costs?

The largest percentage of non-attributed costs involve mail delivery activities. Out of the 37% of non-attributed costs in R2000-1, approximately one-half involve carrier delivery functions. These non-attributable costs include nearly all of the time a carrier spends on the route going from delivery point to delivery point. Even if no mail is delivered, the carrier will traverse the route without taking time to load mail in a customer's box or making special deviations to access the box. It is a fixed cost independent of volume, so these costs can not be attributed on the basis of volume variability studies. Likewise, nearly all carriers carry a variety of mail products so no product specific costs exist for route time. An arbitrary assignment could be conjured up, but it would not provide a reliable measure of causality.

I believe that the regulator should regularly revisit each activity to make sure that misestimation is not occurring as postal operations change. Recently the Postal Service performed a new study of city-carrier-street-time costs and reported that it led them to believe those costs were more variable than the previous set of supporting studies, conducted in the 1980s, indicated. Commission decisions over the last ten years have urged updating that data and analysis.

The Postal Service has been unwilling to make the data underlying its analysis publicly available on the Commission website; however, its analysis will be formerly introduced in the next rate case and will undoubtedly be examined closely. Such careful review of changes in attributable costs reduces the chance of errors in calculation that could be harmful to mailers and competitors of the Service.

The attribution of costs is a careful, technical search for accuracy. This benefits the nation's consumers by accurately identifying cost relationships among the monopoly products and the cost effect of monopoly and competitive products efficiently benefiting from the economies scale and scope inherent in the Postal Service's national delivery system.

It is understandable that businesses that compete with the Postal Service are concerned that competitive products cover their attributable costs and make adequate contributions to Postal Service overhead. The best way to assure that proper contributions to overhead are collected from each product is to directly address the size of the contribution that competitive products should make in the legislation. Arbitrarily legislating that a set proportion of total costs are "attributable" will only undermine captive mailers' faith that their rates are fairly cost-based.

A MODERN SYSTEM OF POSTAL RATEMAKING

The most recent versions of postal reform legislation, S. 1285 and H.R. 4970, provide for the regulator to develop a modern ratemaking system in an open process after eliciting the views of all interested parties. I believe that is the most effective way to assure that postal management has sufficient flexibility to quickly and effectively meet the needs of the nation in general and postal patrons in particular. I will not today prejudge what attributes should be included in such a system.

I do have some thoughts about specific procedures for assuring protection of the mailing public suggested by the President's Commission on the Postal Service. The

President's Commission recommended that postal rates be subject to a price cap mechanism, a concept that is widely supported and is not objectionable. However, I think it is important to comment on the need to assure that any price cap is meaningful and that mailers have sufficient advance notice of new rates to confirm that they do not violate the cap.

Price Caps

Some stakeholders have endorsed the concept of price cap regulation, suggesting that specific rate caps be memorialized by statute. This suggestion is at odds with both the previous Senate and House bills and, in my view, is inimical to sound postal regulatory reform.

Both the previous Senate and House bills suggest various pricing mechanisms for regulating the rates and classes of market dominant products, including, for example, price caps, revenue targets, and cost of service regulation. (S.1285 § 3622(d) and H.R. 4970 § 3622(d)). Neither bill mandates specific pricing caps or otherwise requires that a specific pricing regime be used. Flexibility is the hallmark of each of these pricing provisions and it should be preserved in any legislation on postal reform.

In his recent testimony, Postmaster General Potter outlined the Postal Service's view of an appropriately constructed price cap. It would consist of at least four components, comprised of cost indices to measure fuel, network expansion, and wages, plus accounting for the actual growth in statutory benefits. I must suggest that this formulation should not be enshrined as a permanent price cap.

First, the cap described by the Postmaster General would be essentially the Postal Service's costs, and thus it would fail to impose any meaningful fiscal discipline on the Service's operations. Second, while such a pricing scheme might satisfy the Postal Service's desire for pricing flexibility, it comes at too high a cost. It strips mailers of their current ability to offer input concerning pricing proposals and changes in cost methodology, while, at the same time, handcuffing the regulator's ability to address the

bills' mandate to establish a modern system for regulating rates and classes for market-dominant products. Finally, the inflexibility of such a system is inconsistent with the objectives of the proposed legislation, elevating pricing predictability at the expense of incentives to reduce costs.

The existing statute offers a telling comparison. Currently, the Postal Service operates under a break-even requirement, *i.e.*, that postal rates and fees yield sufficient revenues to equal as nearly as practicable the Postal Service's total estimated costs. By default, the Postal Service's cost projections have become a proxy for the break-even requirement. While Postmaster General Potter deserves praise for aggressively cutting the Postal Service's costs, it is undeniable that the current statute does not provide an effective incentive to motivate the Postal Service to reduce costs or improve efficiency. Any proposed pricing regime establishing such a generous permanent price cap would, I believe, do little more than perpetuate this system, one devoid of any consequential means to impose fiscal discipline on the Postal Service concerning its market-dominant products and services.

Both bills previously under consideration require the Postal Regulatory Commission to promulgate, within 24 months after enactment of reform legislation, regulations establishing a modern system for regulating rates and classes for market-dominant products. Each bill outlines the objectives of such a system and enumerates 12 factors that the Commission is to take into account. The rulemaking establishing these regulations will permit all interested stakeholders an opportunity for input. This is an important consideration, as is the fact that the results will not be set in stone, as they necessarily would be if price caps were legislated. Notably, each of the proposed bills contemplates that it may be necessary from time-to-time to revise the regulations. The flexibility inherent in this system is a crucial element in a modern system of rate regulation that must keep pace with changing market dynamics.

On the one hand, the regulations can be designed to accommodate the Postal Service's desire for pricing latitude. On the other hand, the opportunity to revisit the

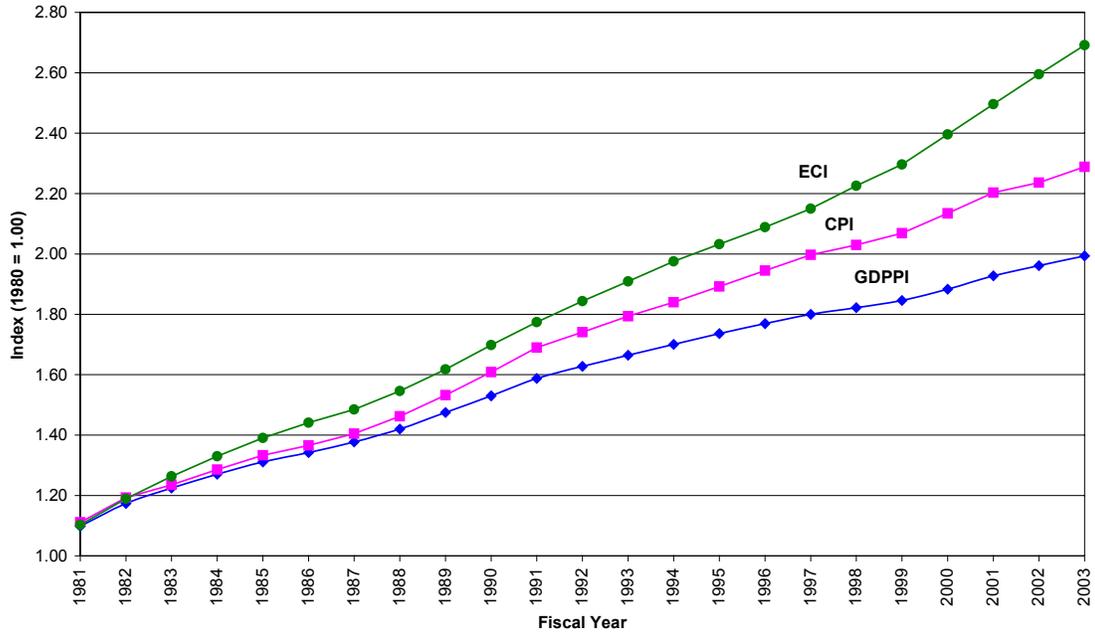
regulations, either by the Commission *sua sponte*, at the request of the Postal Service, or upon complaint by an interested person, ensures that over time the regulations will remain faithful to the legislative objectives despite changing market conditions, incorporating enhancements in costing methodology and productivity. Furthermore, as a policy matter, absent any intervening reviews of the regulations, it probably would be appropriate that the regulations be subject to some periodic review, *e.g.*, at least every seven years.

Developing an appropriate price cap should be feasible. As I mentioned, it has been suggested that because the Postal Service must accommodate an atypical mix of cost-driving expenses, some of which are beyond its control, an appropriate price cap regulatory regime must include multiple cost-index components, including fuel, network expansion, statutory benefits, and ECI wages. While the premise for this functionalized approach to price caps seems plausible, it is unjustified because it is unnecessary.

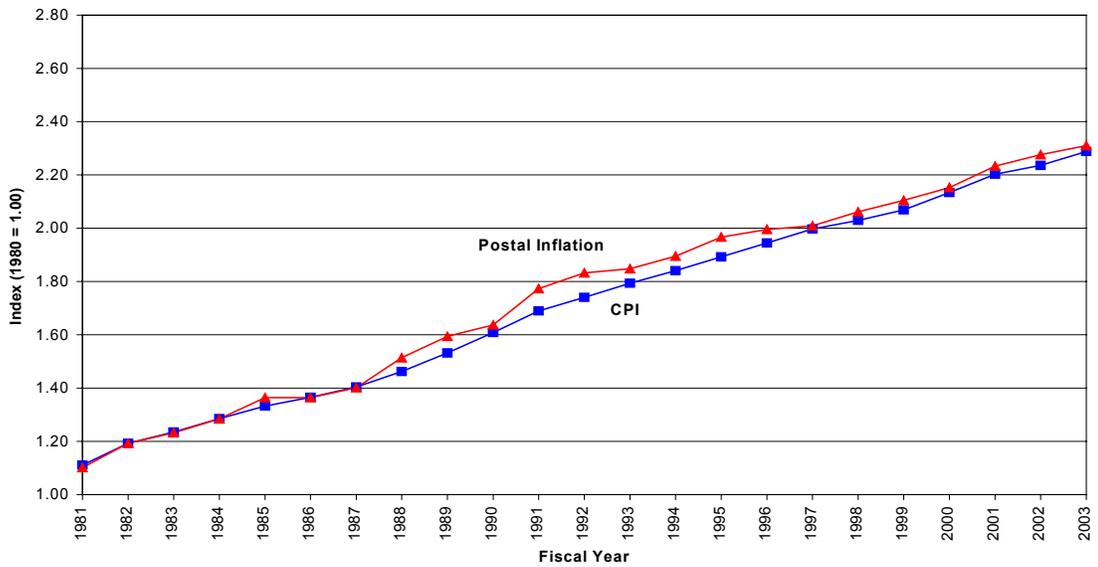
The Postal Service's Total Factor Productivity (TFP) report presents an index of postal inflation. It consists of the total costs of the Postal Service divided by its workload. Over the last two decades, postal inflation has almost exactly tracked increases in the Consumer Price Index (CPI).

The graphs below show this relationship. The top graph depicts three common indices of cost inflation, the Employment Cost Index, the CPI, and the Gross Domestic Product Price Index. One important reason for Postal Service cost inflation is the fact that it is a highly labor-intensive entity, and labor costs (as shown by the Employment Cost Index) have increased faster than the CPI. Despite this fact, as shown on the bottom graph, postal inflation has closely tracked the CPI through good times and bad.

**Gross Domestic Product Price Index (GDPPI), Consumer Price Index (CPI),
and Employment Cost Index (ECI) Compared
1981-2003**



**Consumer Price Index (CPI) and Postal Inflation (PI) Compared
1981-2003**



Thus, to introduce incentive ratemaking, it would appear reasonable to use CPI minus X (where X is an efficiency adjustment goal) for price caps applicable to market-dominant products. In contrast, adoption of the suggested functionalized approach likely would stimulate little if any additional management dedication to controlling costs throughout the postal system.

Incentive rate regulation for market-dominant Postal Service products should pose significant challenges to postal management that will serve both to enforce fiscal discipline and to spur ingenuity in identifying and exploiting opportunities to improve productivity and reduce costs. This mandate was made explicit in earlier stages of the current postal reform initiative. Illustratively, in the 106th Congress, H.R. 22 incorporated a mechanism for limiting rate increases for market-dominant products to increases in the Consumer Price Index, adjusted by a factor based on likely Postal Service productivity and specific cost savings.¹ The proposed legislation explicitly required that the adjustment factor be a negative value or zero;² *i.e.*, that the maximum permissible rate increase would be the increase in CPI or less. In my view, the keen edge of incentive ratemaking should not be dulled by lax benchmarks of cost escalation or by easily available escapes from price caps on the ground of "exigent circumstances."

Exigent Rate Cases

The modern system of rate regulation envisioned by the proposed legislation would afford all stakeholders an opportunity to address what types of "exigent circumstances" might justify allowing rates in excess of the price cap, both during development of the initial regulations and in subsequent reviews. This is an important consideration given the natural tension between permitting the Postal Service pricing latitude and protecting the public from pricing mechanisms in which the Postal Service's costs become the *de facto* rate floor.

¹ H.R. 22, 106th Cong., 1st Sess. § 201, proposed 39 U.S.C. § 3732(c)(1) (1999).

² H.R. 22, 106th Cong., 1st Sess. § 201, proposed 39 U.S.C. § 3733(c)(2) (1999).

Postal reform should provide a balanced and flexible approach for establishing postal rates and fees. The flexibility inherent in the previously proposed provisions should be retained, including a “safety valve” opportunity for the Postal Service to recoup costs resulting from extraordinary, unforeseeable expenses that would otherwise drive rates above the price caps. The mechanism for doing so would be an extraordinary or “exigent” rate request by the Postal Service. For example, H.R. 4970 would allow the rates for a market-dominant product to increase beyond the comparable rise in the Consumer Price Index if the regulator finds such increase “reasonable and equitable and necessary to enable the Postal Service ... to maintain and continue the development of postal services of the kind and quality adapted to the needs of the United States.”

If an “exigent” rate request mechanism is likely to remain a feature of postal ratemaking reform, several observations must be made.

The availability of any such mechanism represents an enormous exception to the general thrust of postal ratemaking reform as it has been considered to date. Incentive-based ratemaking, and the management discipline it is intended to enforce, have been central to the vision of a reformed Postal Service.³ A mechanism for regularly exceeding the rate levels around which postal management is expected to make its operational plans could completely undermine this central objective.

If ratemaking reform is to achieve the intended purposes of heightened management vigilance over costs and enhanced operational efficiency, the “exigent” request mechanism must not be allowed to erode or ultimately supersede the new system of incentive rates. For this reason, final authority to establish the appropriate

³ As one analyst has noted, “[Congressman McHugh’s] Subcommittee’s reform proposal advocating price cap pricing regulation for the USPS became the central vision around which the reform discussion turned.” Reisner, Robert A. F., *Price Caps and the US Postal Service; Prospects, Perils and the Public Interest*, p. 3, presented to the President’s Commission on the United States Postal Service, May 29, 2003.

level of revenues to be recovered through exigent rate increases should reside with the regulator, not the Postal Service. Judicial review of such determinations should be made available to ensure appropriate oversight and relief.

Further, there should be a shared understanding that “exigent” rate requests are appropriate to accommodate only those unanticipated cost increases that are truly extraordinary. Variances in volume levels and ordinary recurring costs should not qualify as a source of “exigent” circumstances; these are contingencies for which postal management can reasonably be expected to plan, and for which it must be expected to adjust. Only those kinds of unexpected cost increases for which vigilant management could not reasonably have planned should provide grounds for “exigent” rate requests.

In my opinion, in the last 25 years there has been only one circumstance that would have justified an exigent rate increase, namely the combined effects of the 9/11 terrorist and anthrax attacks of late 2001. Because of the urgent nature of exigent requests, I would expect them to be considered with extreme expedition, with the focus exclusively on the nature of the emergency, and on quantification of the need for emergency financial relief.

Prior Review of Market Dominant Rates

Although S. 1285 and H.R. 4970 would leave it to the regulator to determine what substantive criteria to emphasize in setting market-dominant rates (price cap, cost of service, etc.), it is not entirely clear what procedural latitude they would give the regulator to implement the rate-setting system that it selects. Section 3653 requires the regulator each year to prepare a report, with public input, determining whether the rates that the Postal Service charged during the past year were in compliance with the statute and implementing regulations. Section 3662 requires the Commission to review third-party complaints that current rates and services do not comply with the statute or its implementing regulations. These forms of review of Postal Service rates and service performance are the only ones mentioned. S. 1285 and H.R. 4970 do not, by their terms, make these forms of review exclusive; however, one might argue that by not

mentioning any others, they imply that the regulator is not authorized to use other forms of review.

I agree with many of the recommendations of the President's Commission, but I don't agree with its recommendation that rates for market-dominant products should be reviewed only after they have been implemented. I question the need for postponing review until after implementation, and the practical value of such review. If rates have already been implemented, and review by the regulator reveals defects in those rates, there are powerful institutional incentives to ignore defects rather than to correct them, such as to avoid confusion in the marketplace and the disruption of business plans. If the regulator were to identify defects in rates prior to their implementation, rates could be corrected before the marketplace came to rely on them. Because it is least disruptive, a system of prior review will best achieve the objectives of the modern ratemaking system called for by S. 1285 and H.R. 4970.

These bills identify the following objectives for a modern system for setting rates for market-dominant products. The system should promote financial stability, economic efficiency, flexible pricing, predictable rates, and minimize the administrative burden of ratemaking. Economists remind us that those who use market-dominant postal products are, in a sense, "captives" of the monopoly. Recognizing this, I would argue that another objective belongs in section 3622. I believe that rates for market-dominant products should, to the extent feasible, reflect the needs of these captive mailers.

I believe that each of the objectives identified in those bills can be better met by a system where the regulator is left the option of conducting limited and expeditious prior review rather than post-rate implementation review.

Perhaps the most obvious advantage of a system of prior review over after-the-fact review is that it would make rates more predictable. Prior review increases the odds that defects in rates will be identified before they take effect, thereby reducing the need for disruptive short-term shifts of rates from old to new and back that would result

from relying on the post-implementation review. A major accomplishment of the current system of before-the-fact review is that there have been almost no after-the-fact rate complaints for 30 years.

In important respects, a system of prior review would reduce the administrative burden of ratemaking. Bulk mailers generally prepare their mail according to intricate make-up requirements in order to take advantage of bulk mail discounts. This is especially true of mailers of bulk standard mail and Periodicals. Vendors of the software that mailers buy to conform their mail to bulk mailing requirements assert that it usually takes them several months to revise their software to reflect changes in rates and associated make-up requirements. The Postal Service asserts that to accommodate such concerns, a lag time of approximately three months is needed between the notice of a general change in rates, and the implementation of those rates. This provides a strong incentive for avoiding the short-term fluctuation in rates that are associated with after-the-fact review.

Similarly, individuals may purchase fixed denomination stamps when new rates take effect. If those rates have to be rolled back, patrons will be "stuck with" overpriced stamps and may lose the benefits of lawfully capped rates.

Another advantage of prior review is that it avoids the huge administrative headache of refunding postal revenues after they have been improperly collected. The transaction costs of refunding postage are often much larger in relation to the value of the service purchased than are observed in other regulated industries. After-the-fact review of rates has been incorporated into the regulatory scheme in other regulated industries, such as gas, electric power, and telecommunications because there are practical ways to refund revenues to customers. In those industries, a regulated provider of a wholesale service, such as a gas pipeline, typically has a limited number of customers. To implement a refund, the regulator can simply order the pipeline to audit the account of each customer and send it a check in the appropriate amount.

It is also usually feasible to make appropriate refunds to retail gas, electric, or telecommunications customers. The retail provider normally has automated records that track the kind, amount, and duration of the metered commodity that was purchased by each customer under a schedule of improper rates. Because retail customers typically make steady, rather than episodic purchases from the provider, it is usually practical for the regulated utility to program its computers to calculate an appropriate refund and credit it toward a customer's future purchases of the regulated service.

Things are not nearly so tidy in postal markets where the administrative cost of calculating and paying appropriate refunds would be daunting. Collectively, postal customers make hundreds of thousands of mailing transactions with the Postal Service each day, selecting from an array of over 200 distinct postal products, sold with a wide variety of discounts and surcharges. Many of these mailings are submitted and paid for by third-party letter shops that print, insert, and address the mail, pay postage under their own imprint, and bill the client. Although there is a highly automated information protocol called "mail.dat" that records the details of bulk transactions for the largest mailers, most bulk mail transactions do not yet use this protocol. Most are not tracked in the detail necessary to calculate precise refunds at a reasonable cost. The impracticality of tracing single-piece transactions back to individual mailers in order to calculate an appropriate refund is self-evident.

The Postal Service might object that prior review of rates would take away too much pricing flexibility – a primary motive for postal reform. I don't think this is true with respect to market-dominant products. It is important to be able to adjust rates for dominant products without unnecessary delay, but rapid implementation is far more important for competitive products.

It should be borne in mind that pricing flexibility has a number of dimensions, only one of which relates to the timing of new rates. If the option of prior review were added to S. 1285, the bill would still give the Postal Service much greater freedom to price market dominant products than it enjoys under the current system. Under the current

system, it is the Postal Rate Commission's role to review Postal Service proposals, and then determine for itself what an optimal set of rates would be, in terms of the objectives of the statute. The Commission's determinations can only be overruled under unusual circumstances. In contrast, under S. 1285, the Postal Service would be free to determine rate levels and rate relationships (for example, within a band defined by a price cap, and attributable costs). The regulator could not change the rates chosen by the Postal Service unless the regulator could show that they violate statutory requirements, or regulations designed to implement those requirements.

Because mailers must be given time to prepare to pay new rates, prior review would be unlikely to delay implementation of new rates for market dominant products. I believe that prior review can be done expeditiously and effectively if, (1) review is free of the strict procedural requirements that encumber the current system, and (2) the regulator and those impacted by the rates have ready access to the detailed financial information that they need to evaluate whether the new rates conform to statutory requirements. It cannot be overemphasized that for prior review to be quick and effective, detailed cost, volume and revenue information must be current, complete, and available to the public.

Much of the impetus for postal reform has been the Postal Service's complaint that under the current system it takes a year-and-a-half for the Postal Service to prepare and litigate a general change in rates. The reasons that it takes this long require examination.

There are two factors that account for the majority of this delay, and both are avoidable. One is the formal hearing procedure for changing rates mandated by current law. The other is the failure of the Postal Service to publicly document its routine financial reports with the workpapers and data on which they are based.

Under current law, rate proposals must be presented in the context of formal "on the record" hearings in compliance with sections 556 and 557 of the Administrative

Procedures Act (APA). This is the most rigid of all administrative hearing procedures, and it is comparable procedurally to complex anti-trust litigation conducted in Federal civil court.

Most of the four to six months that the Postal Service claims it typically takes to prepare a general rate case is spent preparing the formal testimony of upwards of 40 Postal Service witnesses, with heavy involvement of its legal staff, and many rounds of review and clearance by multiple layers of management.

Some of that period also may be spent documenting financial information to withstand the independent scrutiny that it receives during litigation. This level of documentation, however, should be routinely produced at regular intervals by a public enterprise that participates simultaneously in monopoly and competitive markets to ensure that no subsidies cross from the monopoly side to the competitive side. This would be required under the system that S. 1285 and H.R. 4970 envision. Under that system, the time it takes to produce documentation adequate to this task should not be allotted to any specific rate review effort.

S. 1285 and H.R. 4970 would not require that the formal hearing procedures of the APA, including sworn testimony, discovery, cross-examination, and rebuttal, be followed. The preparation of technical written testimony in support of new rates would not be necessary. The regulator would rely primarily on routinely produced financial reports, fully documented by workpapers and underlying datasets. Under implementing regulations, the regulator would already have obtained and reviewed written and oral explanations of any new studies incorporated into these financial reports.

The rate-setting system envisioned by S. 1285 would essentially eliminate the lead time that the Postal Service currently requires to prepare an across-the-board rate increase. It would dispense with formal proceedings, substituting the use of detailed routine financial reports for regulatory review. When management decides to raise

rates, it will need only to provide notice and a brief statement justifying the legality of the increases.

Under the current system, once the Postal Service submits proposed rates the Postal Rate Commission has 10 months to conduct what amounts to a formal trial of all of the issues that a general rate increase presents. Normally, the Commission spends only six to eight weeks deciding what rates to recommend and preparing its written decision. The Commission usually spends the rest of the 10 months compiling an evidentiary record under the rigid procedures followed in formal civil trials.

The time that the hearing phase usually consumes is unavoidable if the formal procedures of civil trials are to be observed. Time and again the Commission has tried to shrink the time that the hearing phase of its review period takes, but it inevitably encounters vehement objections from either the Postal Service or the intervenors. Both invariably contend that their rights to adequate time to discover evidence, cross-examine witnesses, or rebut the testimony of others is guaranteed by statute and may not be cut short.

Under S. 1285 and H.R. 4970, a system of prior review would drastically reduce the time allotted to the participants to present views. The focus would be on relatively simple issues, such as whether increases exceed applicable price caps.

Under the current system, most of the hearing phase is consumed by what lawyers call “discovery.” Discovery consists mostly of formal written requests to obtain information from others, followed by formal written responses to those requests. These often lead to multiple rounds of motion practice while the participants quarrel about what must, or need not, be produced under intricate rules of evidence.

Most discovery requests ask for financial or operational information that the Postal Service should regularly provide to the public apart from any specific rate review cycle. I expect the regulator to require the Postal Service to regularly provide the public

with the essential financial information that is basic to reviewing rate changes. This information will have to be made public to comply with the transparency and accountability goals that are central to postal reform. Thus, most of the relevant information would already be in the hands of the regulator and the affected public. Because the information relevant to rate review would be available in advance, and streamlined procedures would be available to supplement that information in the unusual circumstance where some additional explanation was necessary, I believe that S. 1285 would allow the regulator to conduct effective prior review in a fraction of the time that is required under the current system.

This conclusion is further buttressed by the fact that far fewer issues would be relevant. The regulator would not be responsible for evaluating the Postal Service revenue requirements, except in rare “exigent” rate cases. The proper methods for measuring the attributable cost of products also would be settled outside of rate cases. Other contentious issues such as rate design and specific rate levels would be left to the discretion of the Postal Service, so long as statutory requirements are met.

Prior review will allow impacted mailers to present their concerns in a public forum. Assuring input from those affected by market dominant rates before the fact would vastly improve the likelihood that these views might be acted upon. Nonetheless, consistent with the modern ratemaking system, the Commission would rarely have cause to alter the rates proposed by the Postal Service.

Finally, the year-and-a-half that it currently takes to complete an omnibus rate case includes two months the Board of Governors takes to review the comprehensive set of rates recommended by the Postal Rate Commission. Under S. 1285 and H.R. 4970, these two months would be dispensed with entirely.

I recognize that the issues before the regulator during prior review of changes in rates for market dominant products will vary depending on the system of rate setting that the regulator selects. For example, the rules adopted by the regulator might

restrain rates for market dominant products by a price cap. This system of regulation would require the Postal Service to apply a set formula to its rates. Reviewing this aspect of new rates should be straightforward, and should be essentially self-executing. Prior review would involve examining the Postal Service's spreadsheets to see if they contained any technical errors.

The regulator might also require that rates for each market dominant product cover its attributable costs. To evaluate this requirement, it would be relevant whether the Postal Service applied a cost estimating technique not approved by the regulator, or used an approved technique incorrectly. Similarly, there might be room for argument as to what constitutes a distinct "product" for cost attribution purposes. Prior review would correct, in advance, rates that were influenced by flawed cost estimating methods or erroneous data. It could also resolve, in advance, ambiguities about how rates should be applied.

I would expect review to be focused, with most attention on rates that display anomalous jumps in overall levels or attributable costs. Scrutinizing proposed rates for such anomalies and correcting them in advance could be done relatively quickly, probably in the time currently allotted for mailers to prepare to implement new rates.

Reducing a complex 18-month process to a limited review that adds no appreciable time to the period mailers need to prepare to implement new rates will vastly simplify ratemaking. It will provide the Postal Service with substantial ratemaking flexibility and allow it to avoid the costs of litigation. At the same time, attention should be given to assuring that the Postal Service gives due attention to the requirements of the law, and the needs of its customers. Before the fact review will provide that assurance.

Although I expect that evaluating simplified rate requests will soon become a relatively routine matter, I suggest that Congress allow the regulator to design this process in consultation with the stakeholders as a part of establishing the system of

modern rate regulation. It is clear that all concerned want this process to be as expeditious and inexpensive as possible, but until comprehensive data reporting rules are in place, and price cap formulas have been designed and tested, rate reviews may take longer than desirable. The regulator, as well as postal management, should be given sufficient flexibility to successfully perform its assigned duties.

THE EXTENT OF THE REGULATOR'S AUTHORITY

Some advocates of postal reform have suggested that the legislation should address two central features of the current postal system in the United States: the postal monopolies over letter carriage and mailbox access, and the obligation to provide universal service throughout the nation. Legislative initiatives to date have shared the objective of preserving the Postal Service's capability to perform the universal service obligation under future circumstances. However, some previous bills have also featured dollar-amount and other limits on applicability of the private carriage prohibition,⁴ and authorization of a demonstration project to determine the feasibility and desirability of private access to delivery mailboxes.⁵

More recently, the President's Commission on the Postal Service has recognized that universal postal service remains vital to the nation and its economy, but recommends against "building rigidities into the system."⁶ To permit some degree of flexibility over the scope of the universal service obligation in the future, it recommends authorizing an independent regulator to "periodically review the universal service obligation as the nation's reliance on its mail system continues to evolve."⁷ More generally, the Commission recommends that the regulator's roles include "defining the

⁴ H.R. 3717, 104th Cong., 2d Sess. Sec. 703 (1996); H.R. 22, 105th Cong., 1st Sess. Sec. 703 (1997); H. R. 22, 106th Cong., 1st Sess. Sec. 503 (1999).

⁵ H.R. 3717, 104th Cong., 2d Sess. Sec. 704 (1996); H.R. 22, 105th Cong., 1st Sess. Sec. 704 (1997).

⁶ "Embracing the Future—Making the Tough Choices to Preserve Universal Mail Service," July 31, 2003, at xi.

⁷ *Ibid.*

scope of the postal monopoly, refining the appropriate components of the universal service obligation, and establishing the bright-line boundaries between the postal monopoly and competitive markets.”⁸

As the Postal Rate Commission commented last November,⁹ these proposals involve issues of national postal policy at the highest level. Delegation of the plenary congressional authority over the universal service obligation and the postal monopoly to a regulatory body would constitute a major departure from the current legal framework. I recognize that Congress, in establishing the contours of postal reform, may or may not decide to reserve its current authority over these matters. However, even if Congress decides to retain such authority, I believe that it would make postal reform more effective if the regulator is given responsibility for interpreting these requirements.

The Universal Service Obligation

Current law requires the Postal Service to “provide prompt, reliable, and efficient services to patrons in all areas and ... render postal services to all communities.”¹⁰ It also prohibits closing small post offices “solely for operating at a deficit,”¹¹ and establishes an appeal process for reviewing decisions to close or consolidate post offices.¹² When the Postal Service decides to make “a change in the nature of postal services which will generally affect service on a nationwide or substantially nationwide basis,”¹³ it is required to submit a proposal to the Postal Rate Commission. Following an opportunity for a hearing, the Commission issues an advisory opinion on the change.¹⁴ In all other respects, the Postal Service determines the manner in which it performs the universal service obligation autonomously.

⁸ *Id.* at 62.

⁹ Comments of the Postal Rate Commission Concerning the President’s Commission on the Postal Service Submitted to the Committee on Governmental Affairs, November 19, 2003.

¹⁰ 39 U.S.C. § 101(a).

¹¹ 39 U.S.C. § 101(b).

¹² 39 U.S.C. § 404(b).

¹³ 39 U.S.C. § 3661(b). The Postal Service has submitted only four such proposals in 34 years.

¹⁴ 39 U.S.C. § 3661(c).

Some of the systemic changes proposed in connection with postal reform have the potential for influencing how the Postal Service approaches the universal service obligation and the postal monopoly. The President's Commission recommends that even if Congress reserves to itself the ability to define these concepts, the interpretation of Congress' will should be assigned to a neutral regulator with authority to take corrective action, if necessary.

This might be necessary because the new ratemaking system could influence the Service's performance of its universal service obligation. Because the strongest form of rate regulation would apply to non-competitive services (including First-Class Mail), there may be an inclination to control costs in a manner that might compromise the level of service provided to users. This response would be particularly likely in the event adverse financial circumstances confront the Postal Service.

On the basis of these and other considerations, the President's Commission recommends that the regulator be assigned jurisdiction over *proposed changes* in service standards that may have a substantial negative national impact. I endorse this recommendation.

The President's Commission does not explicitly address potential erosion in service levels that might result from cost-cutting programs. In my view, the regulator should also have authority to ensure that appropriate levels of service are maintained throughout the nation. It can do so through regular audits of service performance, and by considering complaints of aggrieved postal patrons. S. 1285 and H.R. 4970 contemplate assigning the Postal Regulatory Commission to perform these tasks.

The Postal Monopoly

Much the same considerations apply to the Postal Service's implementation of the postal monopoly. Under current law, the Postal Service is authorized to enforce,

interpret, and suspend application of the Private Express Statutes.¹⁵ As Congress rarely addresses this issue, in effect the Postal Service has been free to define its own monopoly.

Historically, an unstated premise of postal policy has been that the purpose of the monopoly is to assure the preservation of a satisfactory level of universal service. S. 1285 and H.R. 4970 assign the regulator the task of dividing products between competitive and noncompetitive status. I suggest that any legislation effecting postal reform should explicitly direct the regulatory body to consider preservation of an adequate level of universal service as the principal criterion in exercising oversight of the postal monopoly's operation. This oversight should include authority to review all Postal Service proposals to alter its interpretation of what is subject to the private express statutes, and to resolve complaints arising from Postal Service rulings and enforcement actions related to the Private Express Statutes.

As with the preservation of universal service, monitoring the interpretation and enforcement of the postal monopoly can be accomplished through the availability of an effective complaint process. For this reason, the regulator should have authority to impose corrective steps in service complaint cases, as well as in rate complaint cases.

Enforcement

Under current law, there are many instances where the Postal Service does not have a material incentive to comply with the requests and decisions of the Postal Rate Commission, nor is there any material penalty for its choosing not to comply. This hinders the Postal Rate Commission's ability to gather necessary information, and it has occasionally prevented the Commission from performing its statutory functions. The legislation creating the new Postal Regulatory Commission should provide a mechanism for enforcing Postal Service compliance with Postal Regulatory Commission requests and decisions.

¹⁵ 39 U.S.C. §§ 601-606; 39 C.F.R. Part 310.

For example, the Commission issued a final rule in November updating the Commission's Periodic Reporting Rule. This rule directs the Postal Service to provide certain financial conditions and operating results, most of which the Postal Service has already developed for internal use. The goal is to improve transparency, and by allowing parties to better understand what is occurring at the Postal Service, to expedite omnibus rate cases. In response, the Postal Service stated it was "considering" whether or not to comply with this rule.

This type of periodic reporting provides exactly the type of timely information that the new Postal Regulatory Commission will require on an ongoing basis in order to carry out its new and expanded mission. An enforcement mechanism is needed to assure that there is no question that the Postal Regulatory Board and the public have access to all pertinent information.

Another example is the Postal Service's recent refusal to comply with a series of Commission rulings and orders related to the Collection Box Management System (CBMS) in a complaint case concerning the arbitrary cancellation of holiday and weekend mail collection. In part, the CBMS catalogs the public data displayed on the blue collection box labels throughout the nation. The Commission entertained multiple pleadings and issued several rulings and orders giving the Postal Service the opportunity to provide information under protective conditions, to provide a limited response free of protective conditions, or to provide authoritative support to justify non-compliance. The Postal Service refused to cooperate. Its actions delayed the proceeding by at least seven months and hindered the Commission's ability to informatively report on whether the Postal Service was providing an appropriate level of service.

The current complaint system is further flawed in that the Postal Service is under no obligation to react to the findings in Commission reports. This severely undermines the incentive to file a complaint. There is no mechanism to make the Postal Service consider the findings in the report, nor is there an enforcement mechanism to persuade

the Postal Service to take any action. The legislation creating the Postal Regulatory Board also must remedy this situation.

The Postal Service's status as a government entity adds complexity to designing an appropriate enforcement mechanism. There are no principals or shareholders to feel the effects of an enforcement mechanism. Without principals or shareholders, there is no one to influence compliance by transferring the effects of an enforcement action to those within management responsible for compliance.

The Postal Service participates in competitive markets and in a government created monopoly market. The design of an enforcement mechanism should consider that an enforcement mechanism appropriate in one area might not be appropriate in the other area.

In many fields, fines are used as enforcement mechanisms. Fines may not be appropriate in the non-competitive sector of the postal arena as it would not be equitable for the enforcement mechanism to penalize captive ratepayers for the actions of Postal Service management. Ratepayers in non-competitive markets have little recourse but to continue patronizing the Postal Service. Ratepayers in the competitive markets may switch to other service providers, but for most mailers this option may not be viable. Thus, fines might serve only to increase the financial burden on captive customers.

In these circumstances, it is essential that any legislation clearly indicate congressional intent as to the respective areas of authority of the Postal Service and the regulator, and that the postal regulator have all necessary authority to enforce decisions in its areas of responsibility.

THE SIZE AND STRUCTURE OF THE POSTAL REGULATOR

The Postal Regulatory Commission, as proposed, is tasked with broad oversight over Postal Service regulatory and public policy matters. The successful operation of a modern Postal Service makes it imperative that the Postal Regulatory Commission carry out this oversight responsibility in an appropriate, efficient, and timely manner. The proposed scope of responsibilities delegated to the Postal Regulatory Commission exceeds those currently undertaken by the Postal Rate Commission.

The Commissioners will be required to understand and make decisions involving complex technical issues involving the Postal Service and the mailing community. These issues will frequently require analysis involving the disciplines of economics, accounting, business, law, and public policy. The seats at the Commission should be filled with highly qualified and highly motivated Commissioners that have proven qualifications in the above areas. A statement of qualifications appearing within the legislation, such as selecting individuals solely on the basis of their technical qualifications, professional standing, and demonstrated expertise in economics, accounting, law, or public administration, will help guide the selection process to the most qualified individuals.

There are advantages to a five-member Commission as opposed to the three-member body suggested by the President's Commission on the Postal Service. The issues that the Commission grapples with often will be complex and difficult to resolve. Five Commissioners will bring a greater diversity of knowledge and differing perspectives to bear on the issues at hand. With the expanded scope of responsibilities and shortened time frames envisioned for resolving issues, five Commissioners will more efficiently handle the expanded workload, and effectively carry out the assigned tasks of the Commission in a timely manner.

A Commission composed of five Commissioners also mitigates the effect of transitional periods where there is a vacancy at the Commission. The vacancy of one Commissioner out of five is not as likely to result in the absence of a quorum on the Commission than the loss of one Commissioner out of three. It will also reduce the effect of the loss of institutional knowledge caused by the departure of one Commissioner, and assures the continuity of the decision making process of the Commission. This is an important consideration since vacancies have lasted for a number of months while new appointments are made.

The Postal Regulatory Commission decisions should not be politically partisan, and the Commission should operate seamlessly through the normal transitions of parties into and out of office. The presence of five Commissioners will help assure a balanced Commission. A Commission composed of only three Commissioners could reflect too narrow a viewpoint when there is a vacancy and the two sitting Commissioners are of the same party affiliation.

There also are practical considerations that argue in favor of five Commissioners as opposed to three. These matters are exacerbated when vacancies exist. A quorum will be required for the Commission to carry out its official duties. Assuming a Commission composed of three Commissioners, the absence or illness of one Commissioner would effectively provide each of the other two with the ability to bring the functioning of the Commission to a halt by refusing to attend meetings. This prospect could easily undermine the model of a responsive collegial body in which majority rule prevails. For these reasons I urge retention of a five-member Commission.

Resources Needed by the New Regulator

Postal reform is likely to give the Postal Service unprecedented pricing and operational freedom. At the same time, it may establish a new Postal Regulatory Commission with the responsibility to design and implement a system of rules and standards that will govern the Postal Service's exercise of its new commercial freedom.

The new regulator will be expected to apply the new system of rules and standards with unprecedented speed and dexterity.

S. 1285 and H.R. 4970 contemplate what might be called a system of regulation by information. This model depends on the Postal Service to promptly share all relevant information with the new regulator, so that the new regulator can analyze, report, and, if necessary take swift action on the information shared. The new regulator will be expected to develop a modern system of ratemaking while simultaneously preparing and implementing multiple systems for collecting and applying data. It will be expected to develop standards and rules applicable to 19 sets of new regulations, reports, or studies. Many of these may require the regulator to make fundamental policy decisions in areas largely without precedent.

While this work is in progress, the regulator will be expected to expeditiously process the largest and most controversial omnibus rate case ever. This rate case will effect approximately \$70 billion in revenue, and will involve scores of participants and an evidentiary record of tens of thousands of pages. It is expected that the next omnibus rate case will exceed all previous rate cases in its complexity, since it will set controlling precedents in cost methods and rate design that are likely to shape the Postal Service for the foreseeable future.

These obligations will require the Commission to develop revised staffing plans. Because a certain amount of these new obligations will be non-recurring, it may not be appropriate to attempt to employ permanent staff to perform all of these tasks. Therefore consideration will be given to supplementing regular employees by retaining consultants and part-time employees to handle parts of the expanded workload. If Commission resources are inadequate to fund these requirements, it will be necessary to obtain supplemental funds.

Previous reform legislation has contemplated changing the system for funding the regulatory commission to better assure its independence from the Postal Service. I

support that concept. However, I think that the transition to a new system for obtaining funds could seriously impede the Commission's ability to quickly and efficiently meet its new responsibilities. Therefore I urge that a separate provision of law direct that payments from the Postal Service fund be authorized for expenses related to the performance of Commission duties during the first 24 months of its operations following the enactment of reform legislation. The new system for obtaining funds would become effective after that time.