POSTAL
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Testimony of

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Chairman Davis, Ranking Member Marchant, and members of the Subcommittee on Federal Workforce, Postal Service, and the District of Columbia, thank you for the opportunity to be here today. My remarks focus primarily on information developed during the Postal Regulatory Commission's (PRC) 2006 proceeding regarding the Postal Service's "Evolutionary Network Development" (END) plans (Docket No. N2006-1). That proceeding concluded with a Commission Advisory Opinion on December 19, 2006, which is attached to my written statement. I respectfully request that my full statement and attachment be entered into the Record.

The PRC is an independent agency that has exercised regulatory oversight over the Postal Service since its creation by the Postal Reorganization Act of 1970. Primarily that oversight has consisted of conducting public, on-the-record hearings concerning proposed rate, mail classification, and major service changes, and recommending decisions for action by the Postal Service Governors. Under 39 USC §3661, the Postal Service requested an advisory opinion from the Commission on its planned nationwide realignment known as the END process. That provision requires the Postal Service to seek the Commission's advice before implementing nationwide service changes.

The Commission's proceeding brought transparency to the Postal Service's network development plans. When the proceeding started, very little was publicly known about the overall END process, and the Service's vision of its future network was unclear. However, questioning by the Commissioners and participants in the case has

shed needed light on the END program. Additionally, expanded opportunities for public input have been provided. The public now has a more complete picture of what the END program entails. For example, there is now a publicly available list of facilities being considered for consolidation. This opening of the END program to outside scrutiny and the resulting public comment has led to improvements in the process.

The Commission expects the transparency achieved through last year's review of network realignment to continue under the new Postal Accountability and Enhancement Act. The new Act requires the Postal Service, in consultation with the PRC, to establish service standards for market-dominant products and assigns regulatory oversight to the Commission. It also directs the Postal Service and the PRC to consult on developing a plan for meeting these standards, including any necessary changes to the Service's processing, transportation, delivery, and retail networks. Regulations establishing service standards are due in December 2007, and a report to Congress on their implementation is due by June of 2008.

In last year's proceeding, the Commission endorsed the goals, if not the details, of the Evolutionary Network Development program. The Commission recognized both the value of using modern computerized optimization and simulation models to identify candidate mail processing facilities for consolidation, and the need to conduct site-specific reviews of consolidation plans as a reality check on the outputs of the computer models. However, the Commission's

analysis identified significant problems that could result in a less efficient network with slower service.

A basic problem with the END process for rationalizing the Postal Service's network was the determination to consolidate operations, where possible, from smaller plants into larger plants, rather than from less productive plants into more productive plants. The latter approach holds greater promise for making the network more efficient.

Another problem was that transportation was not adequately considered in the Network Development plans. It was not clear how transportation would be realigned since the backbone of the network, the Regional Distribution Centers, was shrouded in uncertainty. The Postal Service estimated there could be anywhere from 28 to 100 such centers. To the Commission, it seemed risky to reconfigure the network without first having a better understanding of the nodes and transportation links that would form this backbone.

Also the network development plans, as of last year, did not consider a significant change in mail processing that will be introduced next month, the Flats Sequence Sorting machines. These machines are huge, expensive, and were not incorporated in the planning models. Consolidations implemented without considering the addition of these machines may now require unanticipated facility expansions and use of annexes.

The Postal Service recognized that its network redesign program could have a significant impact on service. However, it did

not provide a reliable estimate of the volume of mail that would experience a downgrade, or upgrade, in days to delivery. Nor was there an estimate of how often the Postal Service would need to move up collection times on boxes and business mail drop-offs in order to get the mail to processing and delivery units in a timely manner, or the impact consolidations would have on the delivery—most notably delivery later in the day.

The Commission also found that many of the problems were due to assumptions built into the computer models that were driving the nationwide network realignment process. These include:

1. A disconnect between the actual productivity and cost characteristics of processing plants in the current network and the plant characteristics that are assumed in the inputs to the models. As a result of this disconnect, there is a risk that the models will recommend shifting workload from more productive, lower-cost plants to less productive, higher-cost plants.

2. The Postal Service's models assume that existing productivity differences among current plants, which lead to wide variations in unit costs, will become irrelevant in the process of network realignment. There is no reason to expect this will be true.

3. The method the Postal Service uses to develop plant-level marginal costs as inputs for its models rests on

several basic assumptions that appear to be seriously flawed, including:

i. The misassumption that plant size is a reliable indicator of plant marginal processing costs.

ii. The use of cost functions that capture only short-run marginal costs as appropriate guides for the long-term reconfiguration of the postal network.

iii. Confusing the fact that "economies of scale" depend on plant size whereas "economies of fill" are available to any plant of any size.

4. The models do not produce, and the Postal Service did not provide, an estimate of the impact of reconfiguration on transportation costs. From the evidence provided in the proceeding, it is not clear that transportation costs will not increase, potentially offsetting other savings.

The site-specific development and evaluation plans are designed to provide a reality check on the outputs of the models and ensure local input before changes actually occur. Yet several problems were identified that include:

1. A lack of consistency in how proposed consolidations are reviewed;

2. No criteria for approval or disapproval of proposed consolidations;

3. A lack of public and mailer input; and

4. Severe tardiness and errors in analysis in post-consolidation reviews.

The Postal Service, in apparent recognition of certain criticisms identified in the Commission's proceeding, revised its original plan for public involvement during the course of the proceeding. Among other things, public meetings have been added during the Area Mail Processing feasibility study phase, a communications plan (including public notice) has been introduced for Regional Distribution Center activations, and a formal plan has been developed to guide the Post-Implementation Review process.

During the Commission's proceeding, it became clear that the public has an interest in being notified much earlier in the process when the Postal Service is proposing an Area Mail Processing consolidation. Communities sought disclosure of more information on a broader range of topics, more meaningful inclusion in town hall meetings, and the opportunity to develop alternatives as well as provide feedback on the results of consolidations.

This public interest is not unreasonable in light of what the Evolutionary Network Development program puts into play for individual citizens, businesses and suppliers, and affected communities. The consequences, in fact, appear to have the potential — at least for some stakeholders — to be far-reaching. Accordingly, the Commission recommended that the realignment process be supplemented with additional procedures for public input.

In closing, let me reiterate that the Commission believes the Postal Service should have the flexibility and authority to adjust its operations and networks to meet its business needs and create cost savings and efficiencies. However, the Postal Service must be accountable and transparent to all postal customers, and be sensitive to the needs of the communities it serves.

Thank you. I will be pleased to answer any questions you may have.