

POSTAL ISSUES UPDATE

WINTER 2011

Postal Service Faces Continuing Financial Challenges

FY2010 Losses Total \$8.5 Billion

The Postal Service ended its 2010 fiscal year (ending September 30) with an \$8.5 billion loss, the largest in the agency's history. The losses were largely driven by prepayments into the Retiree Health Benefit Fund and non-cash adjustments to Workers' Compensation liabilities based on changes in interest rates. On an operating basis, the Postal Service lost "only" \$500 million, which compares favorably to both FY2009 operating results and the FY2010 plan.

Total mail volume declined 3.5% to 170.6 billion pieces in FY2010. More troubling than the overall volume decline is the continuing change in the "mail mix." Declines in First-Class Mail volume accelerated, while Standard Mail volume

began to show signs of growth in the second half of the year. USPS revenues have historically depended on higher-profit First-Class Mail to fund non-attributable institutional costs. Although growth in Standard Mail is welcome, it takes three new pieces of Standard Mail to replace the margin provided by one piece of First-Class Mail.

Cash Flow Becomes a Concern

At the end of FY2010 the Postal Service had a cash balance of \$1 billion and borrowing authority of \$3 billion, less than the minimum one month's expenses (about \$6 billion) that financial experts recommend. The Postal Service projects that it will have a \$2.7 billion cash shortfall at the end of FY2011, meaning that they will be unable to make the \$5.5 billion retiree health benefit prepayment scheduled for September 30. In addition, if the Postal Service uses its full \$3 billion borrowing authority for the year, it will have reached its \$15 billion statutory borrowing limit, which could put FY2012 operations at risk. Postmaster General Patrick Donahoe told a Senate committee that the USPS would either not make the prefunding payment or stop making other retirement contributions in order to continue postal service for the nation.

One Bright Spot

The Postal Service reported \$283 million income for the first month of the 2011 fiscal year, compared to a loss of \$221 million last October. Standard Mail volume continued its upward trend, increasing 15.6% compared to the same period last year.

	<u>FY 2010</u>	<u>Change from FY 2009</u>
Financials		
Total Revenue	\$67.1 billion	(1.5%)
Operating Expense	\$67.6 billion	(2.3%)
Operating Income	(\$0.5 billion)	
Retiree Health Benefit		
Prefunding	(\$5.5 billion)	
Workers' Comp Adjustment	(\$2.5 billion)	
Net Loss	(\$8.5 billion)	
Volume		
Total Mail Volume	170.6 billion	(3.5%)
First-Class Mail Volume	78.2 billion	(6.6%)
Standard Mail Volume	82.5 billion	0.1%

USPS Leadership Changes

The executive suite at Postal Service headquarters has seen two significant changes recently:

John E. Potter retired after nine and a half years as Postmaster General and was succeeded by his deputy Patrick R. Donahoe. The choice of Donahoe as the 73rd Postmaster General assures continuity in a time of significant change within the postal service. Donahoe is a 35-year USPS veteran and well respected in the mailing industry. Donahoe has said he wants to improve the postal customer experience to make the Postal Service "leaner, faster, smarter" in the years ahead.

Donahoe's previous position as Deputy Postmaster General and Chief Operating Officer will be split into two positions. The COO position will be filled by Megan Brennan, a postal insider who was most recently VP Eastern Area. The DPMG position is expected to be filled from outside the Postal Service.

(USPS Leadership Changes, continued on page 2)

Postal Reform Legislation

Several members of Congress are focusing on comprehensive reforms aimed at providing the Postal Service with a more robust business model and a more stable financial future.

Sen. Thomas Carper (D-DE), chairman of the Senate postal oversight subcommittee has introduced the Postal Operations Sustainment and Transformation (POST) Act of 2010. Provisions of the bill include:

- remediation of postal retirement funding issues;
- allowing the USPS to offer non-postal products that are in the public interest;
- reaffirming USPS authority to reduce delivery frequency;
- allowing partnerships with state and local governments.

Carper's legislation covers many of the topics included in the USPS's own financial stabilization plan and is strongly supported by the Postal Service.

Sen. Susan Collins (R-ME), ranking member of the Governmental Affairs Committee has introduced her own

version of postal reform, the Postal Service Improvement Act of 2010. Provisions of this bill include:

- remediation for postal retirement funding issues;
- changes to USPS contracting authority;
- requiring the Postal Regulatory Commission to issue an annual report on the fiscal health of the U.S. mailing industry; and
- requiring the Postmaster General to develop a plan for area and district office consolidation.

Sen. Collins secured the endorsement of a number of key postal groups, including the Direct Marketing Association, the Association for Postal Commerce, and the American Catalog Mailers Association.

Incoming chair of the House postal oversight subcommittee, Jason Chaffetz (R-UT) says he is working with Rep. Darrell Issa (R-CA) incoming chair of the full House Oversight Committee to introduce their own comprehensive postal reform bill early in 2011.

Postage Pricing

Exigent Price Increase Rejected

In October, the Postal Regulatory Commission (PRC) rejected the Postal Service's request for an exigent price increase. While the PRC agreed that the recession-induced volume declines that the USPS cited as the basis for the request met the requirements for extraordinary and exceptional circumstances, it also held that the liquidity crisis facing the USPS was "related to the overly ambitious requirement" to prefund future retiree health benefit premiums. In addition, the PRC held that "the requested increase would neither solve nor delay those problems."

The Postal Service has appealed the PRC decision to the U.S. Court of Appeals for the District of Columbia Circuit. Then Postmaster General John Potter said, "We have a fundamental disagreement with the PRC's interpretation of

the law. We need to understand and define the rules under the current law should the Postal Service find itself in a similar situation in the future." Several industry associations, including the Affordable Mailers Alliance, have asked to intervene in the case in support of the PRC. While the court has granted the USPS's request for expedited consideration, a final decision is not expected until the summer of 2011 at the earliest.

Inflation-Based Price Increase Expected in 2011

The Postal Service is expected to file a price increase request with the PRC in January or February based on its CPI cap. If approved by the PRC the increase is expected to take effect in May 2011. While the final 2010 inflation cap won't be known until mid-January, the USPS has built a 1.3% increase into its financial plan for FY2011.

(USPS Leadership Changes, continued from page 1)

In an unexpected move, 40-year Postal Service veteran Paul Vogel returned to the Postal Service as the new President, Mailing and Shipping Services. A consummate Postal Service insider, Vogel sharply contrasts with former president Robert Bernstock, who came to the Postal Service from the private sector. Vogel's responsibilities include protecting base mail volume, growing new, profitable revenue and volume, improving the customer experience, and creating innovative products and services.

Congress Needs to Quickly Address Postal Retirement Funding Issues

The severe financial difficulties being faced by the Postal Service are being driven largely by two retirement funding issues:

1. The requirement in the Postal Accountability and Enhancement Act of 2006 (PAEA) compelling the agency to fully pre-fund its retiree healthcare obligations; and
2. Historic overpayments into both the Civil Service Retirement System (CSRS) and Federal Employee Retirement System (FERS) pension funds.

No other agency of the federal government is required to prepay its retiree healthcare obligations, nor is such prefunding a common practice in the private sector. In addition, the payment schedule set in PAEA requires the Postal Service to pay more than \$5 billion each year into its Retiree Health Benefit Fund (RHBF), even though the fund already has accumulated a balance of more than \$35 billion, which is far in excess of current requirements.

In separate studies, both the USPS Office of Inspector General (OIG) and the Postal Regulatory Commission (PRC) have identified overfunding of the Postal Service's CSRS pension obligations by amounts that range from

\$50 billion (PRC) to \$75 billion (OIG). In addition, a separate study by the OIG identified a \$5.5 billion overfunding of the Postal Service's FERS pension obligations, which the OIG described as part of an "unsettling trend of the Postal Service paying more than its fair share of retiree benefits payments owed to the federal government."

If the pension overpayments were applied to the pre-funding of the RHBF, that obligation would be fully funded, eliminating the requirement for additional annual payments from the Postal Service. Without the annual pre-funding payments into the RHBF, the Postal Service would have shown cumulative income of \$700 million over the past four fiscal years (2007 – 2010) rather than the cumulative \$20.2 billion loss they accrued in the same period.

Correcting these postal retirement funding issues is imperative. The need to fix postal retiree health benefit and pension funding is the one thing all postal stakeholders agree on, and Congress should act to resolve these issues. Once postal retirement funding is addressed, attention should then be turned to more comprehensive postal reforms.

Postal Service Marketing Initiatives Aim to Increase Revenue

The Postal Service has announced two marketing initiatives and a new product that will be available in January.

- **Reply Rides Free** is an incentive program for automation First-Class letters that include a Business Reply Mail or Courtesy Reply Mail insert. To participate in the program mailers must meet a minimum volume threshold and document the number of pieces containing reply mail weighing between 1.0 and 1.2 oz. While the mailer pays the "additional ounce" cost when these pieces are initially mailed, the mailer will receive a rebate at the end of that cost. The goal of this program is to encourage greater use of reply mail and to allow mailers to include more promotional pieces in their First-Class Mail.
- The **Saturation/High-Density** incentive program is a continuation of 2010's Saturation incentive program, adding High Density to the existing Saturation program.

In this program, rebates are given for incremental volume above a threshold based on the previous year's volume of this type of mail. To participate in this program, mailers must already be using Saturation or High-Density rates.

- **Critical Mail** is a new product under the Priority Mail umbrella. It is letter- or flat-sized mail that carries a delivery confirmation barcode and is handled as First-Class through the USPS network. The product features secure mailbox delivery on first attempt with Delivery Confirmation included in the base price. Signature Confirmation is available for an additional fee (\$1.95). The product is designed to support mechanical insertion and the base price (letter: \$3.50, flat: \$4.25) is lower than true Priority Mail.

If you are interested in learning more about either incentive or the Critical Mail product, please contact your IWCO Direct sales executive or client service representative.

Postal Briefs

Five-day Delivery and Operations

The Postal Service continues to prepare to launch its five-day delivery proposal. Implementation planning is well underway, and includes all major USPS departments and operations. However, the USPS cannot move forward unless Congress lifts the legal mandate for six-day per week delivery that has been included in all postal appropriations language since 1983.

The USPS has requested an “advisory opinion” from the Postal Regulatory Commission on whether its five-day proposal meets its legal obligation to provide universal postal service throughout the nation. The PRC is expected to issue its opinion before the end of 2010. That opinion is expected to be the basis of Congressional debate on the subject when comprehensive postal reform bills are considered in 2011. To date there has been strong opposition to the five-day proposal in Congress, with the proposal being defeated in several key committee votes.

The Postal Service says it will require six months to implement the change if permission is granted, so no changes in delivery schedule are expected before late 2011 at the earliest.

Intelligent Mail Implementation

Beginning in May 2011, mail claiming any automation discounts must use an Intelligent Mail barcode (IMb). While mail with Postnet barcodes will still be accepted, it will no longer qualify for automation discounts.

In addition, all business and courtesy reply mail must use IMb in May. If you are using business or courtesy reply envelopes or cards, be sure they are converted to IMb so that the stock being used in May will be compliant.

If you have questions about either of these requirements, please contact your IWCO Direct client service representative for assistance.

Labor Negotiations

Postal Service contracts with two of its largest unions expired on November 20. The Postal Service spent two months in negotiations with the 221,000-member

American Postal Workers Union (APWU) and the National Rural Letter Carriers Association (NRLCA). Issues in the negotiations included concessions on wages, health benefits and working conditions, as well as expanding the use of part-time workers to better match resources to workload. Negotiations with the NRLCA ended unsuccessfully and are going to binding arbitration. Talks with the APWU have been extended into early December, and are on-going at the time this is being published.

Due to the critical nature of postal services, postal workers are not allowed to strike. When negotiations reach an impasse, the next step is mediation (as long as both sides agree), and if that does not work the contracts will go to binding arbitration, in which case a contract is imposed by a three-member arbitration board.

The Postal Service's other two large unions, the National Association of Letter Carriers (NALC) and the National Postal Mail Handlers Union (NPMHU) have contracts that expire in November 2011.

Service Performance Falls in Q4

Q4 2010 was the first quarter the Postal Service used live Full-Service Intelligent Mail data to measure service performance, versus the pilot participant data previously used in measurement. The change resulted in significant declines in the measurements. At the November Mailers Technical Advisory Committee meeting, SVP intelligent mail and address quality Tom Day said that the Quarter 4 results were “disappointing,” and reported that the USPS is “digging into the data” to determine the issues. Steve Forte, SVP operations, commented, “The good news is that we have data, and the performance is going to improve.”

USPS Service Performance FY2010 (Percent On-time)			
Mail Class	Target	Q4	Annual
Standard Mail			
Drop Shipped	90.0%	76.8%	83.4%
Origin Entered	90.0%	38.4%	59.0%
Presort First-Class			
Overnight	96.5%	84.7%	93.4%
2-day	94.0%	84.6%	92.7%
3 to 4-day	92.7%	86.9%	88.2%

