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POSTAL REFORM: THE CHAIRMEN'S PERSPECTIVES ON GOVERNANCE AND RATE-SETTING

HEARING

BEFORE THE

COMMITTEE ON GOVERNMENTAL AFFAIRS UNITED STATES SENATE

ONE HUNDRED EIGHTH CONGRESS

SECOND SESSION

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POSTAL REFORM: THE CHAIRMEN'S PERSPECTIVES ON GOVERNANCE AND RATE-SETTING

WEDNESDAY, APRIL 7, 2004

U.S. SENATE,
COMMITTEE ON GOVERNMENTAL AFFAIRS,
Washington, DC.

The Committee met, pursuant to notice, at 10:03 a.m., in room SD–342, Dirksen Senate Office Building, Hon. Susan M. Collins, Chairman of the Committee, presiding.

Present: Senators Collins, Akaka, Carper, and Lautenberg.

OPENING STATEMENT OF CHAIRMAN COLLINS

Chairman COLLINS. The Committee will come to order. Good morning.

I would like to welcome everyone to the Committee's final hearing on Postal reform. Many of you thought we would never get to this point. Today marks the eighth in a series of hearings that the Committee began last September. Our Senate hearings have focused on the 35 legislative and administrative recommendations of the President's Commission on the U.S. Postal Service, recommendations that are designed to help this 225-year-old service remain viable over the long term.

So much depends upon the Postal Service's continued viability. The Postal Service itself has more than 730,000 career employees. But less well known is the fact that it is the linchpin of a $900 billion mailing industry that employs nine million Americans in fields as diverse as direct mailing, printing, catalog production, paper manufacturing, and financial services. The health of the Postal Service is essential to thousands of companies and the millions that they employ.

At our first hearing in September, the Committee heard from the Commission's Co-Chair, Jim Johnson. Commissioner Johnson made the very important point that the Postal Service's short-term fiscal health is illusory and that Congress must not ignore the fundamental reality that the Postal Service as an institution is in serious jeopardy.

At the Committee's second hearing last November, we heard from Postmaster General, Jack Potter, and Comptroller General, David Walker. In his testimony, Mr. Walker of the General Accounting Office shared the Commission's concerns about the Postal Service's more than $90 billion in unfunded liabilities and other obligations. He pointed to the need for fundamental reforms to mini-

mize the risk of a significant taxpayer bailout or dramatic Postal rate increases.

In February, the Commission heard from representatives of the four largest Postal unions, along with postmaster and supervisor associations. The Commission's controversial workforce-related recommendations were discussed at great length during that hearing.

In March, the Committee held 2 days of hearings in which we heard from members of the mailing community and Postal competitors. We focused not only on the workforce and financial recommendations, but also heard testimony on the Postal Service's monopoly and mission, the rate-setting process, and corporate governance issues.

Last month, I joined House Chairman Tom Davis to conduct a joint Senate-House hearing at which we took testimony from Treasury Secretary Snow, Postmaster General Potter, and the Postal Service Board of Governors Chairman David Fineman, who is with us today, as well. A focal point of the hearing was the administration's strong opposition to returning the military pension obligation to the Treasury. I urged Secretary Snow to work with Congress to resolve not only the military pension obligation issue, but also to solve the escrow fund issue, which I consider to be key to reform.

Today, we will focus on the recommendations pertaining to the reform of the rate-making process and changes recommended by the Commission in the structure of both the Postal Rate Commission and the Postal Service Board of Governors.

As a Senator representing a largely rural State whose citizens depend heavily on the Postal Service, I appreciate the Presidential Commission's strong endorsement of the basic features of universal service—affordable rates, frequent delivery, and convenient community access to retail Postal services. It is important to me that the citizens of my State, whether they live near our northern or western borders, or on islands, or in our many small rural towns, have the same access to Postal services as the people living in our large cities.

We must save and strengthen this vital institution upon which so many Americans rely for communication and for their jobs. The Postal Service has now reached a critical juncture. It is time for action, both by the Postal Service and by the Congress.

Senator Carper, Senator Akaka, Senator Stevens, and others on this Committee have committed to working with me to draft a bipartisan Postal reform bill. We are also working closely, mindful of the short time remaining this year, with House leaders on Postal reform, including Chairman Davis and Congressman McHugh.

I am very pleased today to have the benefit of hearing from the Postal Rate Commission Chairman and the Postal Service Board of Governors Chairman. I am very pleased that you are both able to join us today along with the General Counsel of the Postal Rate Commission and I look forward to your testimony.

Before we proceed to our witnesses, I would like to call on my colleagues, who have been very active in Postal reform, starting with Senator Akaka.

OPENING STATEMENT OF SENATOR AKAKA

Senator AKAKA. Thank you very much, Madam Chairman. It has been my pleasure to sit next to you and to work with you on the many issues that have come before our Committee. I want to thank you for giving so much of your personal attention to ensuring the fair and open forum in which we have reviewed the recommendations made by the Commission on the Postal Service. Your commitment to crafting a bipartisan Postal reform bill is deeply appreciated, and as our hearings come to an end and the drafting process begins, I also want to thank your staff, who has worked diligently on this.

I am especially pleased that today's hearing will focus on proposed changes to the rate-setting process and governance issues. Ensuring the stability and viability of the U.S. Postal Service has long been an oversight responsibility of this Committee and of great importance to me. We understand the consequences of ignoring the challenges facing the Postal Service, but we also recognize opportunities that change may bring.

I have repeatedly said that there must be a greater financial transparency within the Postal Service. As did the General Accounting Office, the Commission found that the Postal Service's financial reporting has not always provided a clear picture of its fiscal condition. I am pleased that the Postal Board of Governors is taking steps to address this issue.

Financial transparency and accountability is essential if the Postal Service is to have greater flexibility over setting its rates. I support putting in place mechanisms that will allow the Postal Service to respond more quickly to changing economic conditions or events that impact the delivery of the mail. To do so, however, we must ensure that the financial information is current and that it is available in a timely manner. I also believe that members of the Board of Governors should have additional resources to hire staff, which will increase the Board's independence and effectiveness.

Freedom to set rates will also require greater oversight by Congress, especially since the Commission recommends giving the proposed Postal Regulatory Board significant authority to set broad public policy in the area of rates, compensation, and the definition of universal service.

Chairman Collins, I look forward to this hearing and I thank our very distinguished guests and witnesses, Chairman Omas, Chairman Fineman, for joining us today, and also Mr. Sharfman. Thank you very much.

Chairman COLLINS. Thank you very much, Senator. Senator Carper.

OPENING STATEMENT OF SENATOR CARPER

Senator CARPER. Thanks, Madam Chairman. To my colleagues and to our witnesses here today, welcome. It is good to see you all. I haven't seen Mr. Fineman for a while. Actually, we rode down on the train together, same car, just on the other side of the aisle. We have already gone through our questions. I thought his answers were excellent. [Laughter.]

We didn't get into a great deal of detail, but thanks for coming. Thanks for being a great customer for Amtrak, too. [Laughter.]

Madam Chairman, I think this is the last in a series of hearings that have been helpful for me, I hope for our Committee and for our staffs, and I just want to express my thanks to you, your staff, and to our own staff, my own staff, for the work that has been done in arranging these hearings and scheduling them.

I think both the Board of Governors and the Postal Rate Commission have performed admirably since their creation, especially in recent years, and I want to commend Chairman Fineman and a previous Board of Governors Chairman who is not here today, Bob Rider, who is one of our constituents in Delaware, a good man.

Chairman Omas and Mr. Sharfman—will you help me pronounce your last name? Is it Sharfman?

Mr. SHARFMAN. You have it correct.

Senator CARPER. Great, three for three. I am usually not that good. I want to commend Postmaster General Potter and the Postal Service for having made it through some tough times. If you go back and think about it, in recent years, we have had a catastrophic terrorist attack, actually a series of them. We have been faced with bioterrorism. We have seen a recession. The Postal Service has come through it in remarkably good shape.

Through it all, the Postal Service has remained a linchpin of a $900 billion mailing industry and continues to reach every home on my block, every home in my State, every business in all of our States, every home, 6 days of the week.

Having said that, as we celebrate the Postal Service's notable successes, I think it is important that we focus on what needs to be done going forward if the Postal Service is going to be as successful in the next 30 years as it has in the last 30 or so years. In spite of the strong leadership that we have seen from Chairman Fineman and his predecessor and Chairman Omas and his colleagues, I have come to the conclusion that some changes are needed at the Board of Governors and some changes are needed at the Postal Rate Commission.

S. 1285 is the number given to the comprehensive postal reform legislation that I introduced last year, and that legislation recognizes this truth and so do the recommendations of the Presidential Postal Commission.

My legislation turns the Board of Governors into a body more likely to be able to steer the Postal Service through the challenging years that lie ahead by requiring that members have some experience managing an organization, I am tempted to say the size of the Postal Service, but there aren't many organizations the size of the Postal Service, but some experience in managing large organizations.

My legislation also improves qualifications for the members of the Postal Rate Commission, requiring that Commissioners have backgrounds in areas like economics, accounting, and law. Those Commissioners are also given more power to demand information from the Postal Service, along with new authority to regulate something that we call service standards, so that the Postal Service cannot try to cut back on service when times get tough instead of finding efficiencies.

I am pleased that the recommendations from the President's Commission dealing with governance and oversight are largely

similar to what we put on the table with S. 1285. The President's Commission also recommends improving qualifications for governors and commissioners and gives the Postal Rate Commission some important new powers. I believe that they may go a little too far in some instances, and we will talk a bit more about that here later.

But let me say that I fear that having a—and I mentioned this to Mr. Fineman today on the train—that the idea of having a majority of the members of the Board of Governors not being confirmed by the Senate will weaken Congressional oversight over the Postal Service and I think we need to be careful before we take that step because the Postal Service is important to us every day. It is important that most, I think, if not all of the members of the Board of Governors should be confirmed by the Senate.

In addition, to protect against the Board not becoming too political, I think it is important that we maintain the notion that the Board be bipartisan and the governors only be removed for cause, and we will have ample opportunity to explore that here in a moment.

In this vein, I think it is also important the governors serve for longer than just the 3 years that the Commission suggests.

Second, let me just say it may not be appropriate to give the Postal Rate Commission the authority to unilaterally change universal service and the scope of the Postal Service's monopoly. I can understand why some would want to leave this authority in the hands of Congress. However, I believe we should give the Commissioners the authority to interpret the definition of universal service in current law as we do in the bill that I proposed.

In closing, Madam Chairman, thanks again very much for really helping us to have a very helpful series of hearings. I believe that what we need to do with Senator Akaka and others on our Committee once we conclude this hearing is to get to work—I know we have been to work, but to finish the good work that has begun. We look forward to putting together just an excellent bill that we can present to our colleagues, hopefully later this month. Thank you.

Chairman COLLINS. Thank you, Senator.

I would now like to introduce our two witnesses, our three witnesses, I should say, who have joined us today.

George Omas is the Chairman of the Postal Rate Commission. He was appointed to that position in November 2001 and has served as a member of the Commission since August 1997. Prior to joining the Commission, he worked for more than 20 years in the U.S. House of Representatives, nearly 18 of those years for the Committee on the Post Office and Civil Service, so I think that he has a great understanding of the challenges of putting together Postal legislation and we appreciate his expertise.

He is accompanied today by Stephen Sharfman, the General Counsel to the Postal Rate Commission.

David Fineman is the Chairman of the U.S. Postal Service Board of Governors. He was elected Chairman of the Board in January 2003 and reelected in January 2004. He has served on the Board since May 1995. He is also a long-time managing partner of a prestigious Philadelphia law firm, since I notices your name is listed first.

I want to thank you, Chairman Fineman, for your willingness to return to Capitol Hill so soon after the joint hearing. I felt at the joint hearing that we didn't have an opportunity to hear as fully from you as I would have liked and I appreciate your willingness to return to Washington for our hearing.

Mr. FINEMAN. My pleasure.

Chairman COLLINS. Mr. Omas, we will start with you.

TESTIMONY OF GEORGE OMAS,[1] CHAIRMAN, U.S. POSTAL RATE COMMISSION, ACCOMPANIED BY STEPHEN L. SHARFMAN, GENERAL COUNSEL, U.S. POSTAL RATE COMMISSION

Mr. OMAS. Chairman Collins, Members of the Committee, thank you for providing me with the opportunity to testify on ways to achieve meaningful Postal reform. I understand my full statement will be incorporated into the record, so I will just take a few minutes to focus on some of the most important aspects of Postal modernization.

First, if I may, I would like to recognize Danny Covington and Tony Hammond, two of my fellow Commissioners, who have accompanied me here today.

The Postal Reorganization Act of 1970 focused on taking politics out of the old Post Office Department and allowing the renamed U.S. Postal Service to operate in a more business-like fashion. I think that legislation was a success. The administration has now presented five principles to guide the future evolution of the Postal Service into a more efficient and market-responsive organization. I fully support those five principles.

Postal reform will greatly benefit the Nation if it can revitalize and modernize the Postal Service. However, I urge Congress to keep unchanged the basic character of the Postal Service, that is, to bind the Nation together through correspondence of the people. The Postal Service should become more business-like and it should adopt modern, efficient practices, but it must also retain its essential character as a service provider to the people by their government.

The administration seeks reform that provides the Postal Service with the flexibility to more easily implement best business practices while assuring that the public has transparent access to timely and accurate cost and performance information to assure total accountability.

The responsibility for adopting best business practices and being self-financing, I feel lies with the Postal Service. The responsibility of assuring transparency and accountability lies with the regulator. My testimony discusses in some detail, ways to assure a successful balance of these two missions.

During my tenure at the Postal Rate Commission, the Postal Service has not been totally transparent. It has opposed changes suggested by mailers to make rate cases faster and less complex. It has resisted attempts by the Commission, by the mailers, and by the neutral third parties, such as the GAO, to gain detailed information about Postal Service practices and operating results. I sin-

[1] The prepared statement of Mr. Omas appears in the Appendix on page 34.

cerely hope this culture of confidentiality and resistance to change can be overcome through reform legislation.

With regard to transparency, I fully and totally agree with the testimony of Treasury Secretary Snow, that the private sector confidentiality concerns should not apply to our government-owned Postal Service and that Postal reform requires true and exacting transparency. The public should have broad access to detailed information on cost and service performances that the regulator will analyze in order to assure compliance with all applicable public policy.

The Postal Service and the regulator must work together with mailers to develop a modern system for regulating rates. That system should allow the Postal Service flexibility to meet the needs of all of its customers while establishing a strong and efficient incentive to reduce costs and to increase efficiencies.

One aspect of this system should be to eliminate the adversarial trial-type rate-setting hearings which we conduct presently. If there is a meaningful transparency of Postal Service operations, and in financial data, consumers can be assured that the new rates are consistent with applicable requirements by a brief administrative review. I will elaborate on that point.

Draft reform legislation in the last Congress, Senator Carper's S. 1285 and the House bill H.R. 4970, tasks the new regulator to work with the Postal Service and the mailers to develop a modern rate-making system that meets a number of important policy goals. Such a system would encompass both standards to guide the Postal Service in its pricing and procedures for implementing rate changes.

However, when the President's Commission on the Postal Service provided its thoughts on pricing, it suggested that rate changes be allowed to take effect without any public review. It left mailers to file after-the-fact complaints to correct rates that violate price caps or involve cross-subsidies. I think that recommendation is misguided and I urge that it not be enshrined in legislation.

Rate changes are not a routine matter. Businesses have to purchase and install new programs to compute postage and individuals have to purchase new stamps. Every effort should be made to avoid the disruption that would be caused by complaints leading to rate adjustments.

A far more efficient and mailer-friendly system would involve advance administrative review. This would take advantage of enhanced Postal transparencies to ensure that planned new rates for market-dominant services are within applicable pricing guidelines, such as rate caps, and cross-subsidy prohibitions. A brief administrative review of planned rate changes would not limit management's flexibility.

Rate predictability is a key aspect of total reform, and mailers of market-dominant products must be given ample advance notice of rate changes. Review could easily be accomplished before mailers have to prepare to implement the new rates.

Another key safeguard in the modern system of rate regulation should be a provision allowing for limited exigent rate cases. A reformed rate system should include price caps that give incentives to the Postal Service to reduce cost and increase efficiencies. It

should also allow for exigent rate increases in case unforeseeable extraordinary circumstances threaten the Postal Service's financial stability.

It must be understood, however, that exigent increases are limited to extraordinary circumstances and are not appropriate simply because revenues are mis-estimated or cost reduction programs are not as successful as planned. These types of events are normal in any business and Postal management must be expected to adjust to normal business fluctuations. To assure that the system is not abused, all exigent rate increases for market-dominant products must be approved in advance by the regulator.

Reform legislation that clearly sets out national goals of more modern and more efficient business practices, and meaningful oversight to protect consumers and maintain universal service, will go a long way toward assuring that our Postal Service will thrive in the coming decades. I hope these efforts are successful.

I would be happy to answer any questions you or the Committee might have. Thank you.

Chairman COLLINS. Thank you for your testimony. Chairman Fineman.

TESTIMONY OF S. DAVID FINEMAN,[1] CHAIRMAN, U.S. POSTAL SERVICE BOARD OF GOVERNORS

Mr. FINEMAN. Thank you. As I have indicated to Senator Carper on the Amtrak train coming down and Senator Collins on numerous occasions, I leave the Board on December 8 of this year, having served probably in excess of 8 years on this Board. Actually, Bob Rider and I came to this room and had our Senate confirmation hearings together and it has been a wonderful experience.

But I do think, leave aside everything else, after 8 years, I think it is appropriate not to be reappointed. I don't think that Board members should serve more then 9 years. That would be 17 years on a board of this sort. I would think that would be absolutely inappropriate. So I am not seeking to be reappointed, and I come here in a forthright kind of way to say to you, I only have a few more months left. I want to be as forthright as I can and enter into a dialogue with you about what my experience has been on the Board.

Shortly after I got on the Board, it became clear to me that there needed to be a change in law, and I think both myself and Congressman McHugh at that time were lonely voices out there talking about Postal reform and changes to be made.

What became clear to me, and Chairman Omas referred to it a little bit, is that the rate-making process is so cumbersome. I have referred to it over and over as the Lawyer's Welfare Act of 1970. What it contemplates, to a large degree the way the law was enacted, is an adversary system, and in that adversary system you have various people who intervene in the case and then ask for documents. It becomes very much some sort of an adversarial system, and Chairman Omas has stated over and over that he looks at himself as a judge in a quasi-judicial role. I think it is appropriate, and he has handled everything in an extremely efficient

[1] The prepared statement of Mr. Fineman appears in the Appendix on page 72.

manner as a Federal judge might do, tried to bring people together over periods of time, entered into settlements. But it is a system that doesn't make a lot of sense.

Let's talk about financial transparency. We have received the recommendation from the Presidential Commission, which is a Commission we asked for. The Board said at some point, we ought to have a Presidential Commission appointed. We were happy that they were appointed, and we have begun to institute reforms to try to comply with SEC requirements as they recommended.

But when we talk about financial transparency, if you have the present system, I would say to you, quite frankly, you are not going to get the kind of transparency that everybody seems to want, although I can't understand what else they want, because what you have is this adversarial system.

So every time a rate case starts, what I have talked about in speeches is we back a truck up, literally back a truck up to the Postal Service and put on it tons of documents that then go over to the Postal Rate Commission and that is only the first truck. Then when, to some degree, our competitors ask for different documents, we then back up more trucks and answer questions and expend incredible energy, time, and money into these rate cases that make little sense as to a way to create rates in the present environment that we have.

Let us step back for a minute and look at the world in 1970. FedEx, did it exist? Did it exist in the form that it exists today? Was the dominant force that it is in the package business in 1970 as compared to the Postal Service? When the Senator and I came up, he could have seen me sneaking onto my Blackberry, looking at my E-mails, answering E-mails today. The world didn't exist as it exists today, and that is why Senator Carper's bill and other bills you have talked about having a price cap regimen, I think are really important.

It is really important, and when you look at that, where you are going to have issues, it seems to me they are going to have to be discussed internally. The devil is going to be a little bit in the detail. What is the price cap that you use? You heard from the Postmaster General. He said to you, well, the world didn't exist the same way it existed before. It didn't even exist the same way when we had the first set of price cap regimens that came into existence in telecommunications. There, you used the CPI.

Could we have predicted, as an example, that inflation would be as low today as it is? Probably nobody in this room would have predicted that. So if we used a CPI over the last few years, would the Postal Service be able to accomplish what it accomplishes with that kind of index? I think that is what the Postmaster General was saying to you, and I think that is an issue. I think that what he has done is to bring some light onto that issue and it is an issue that you have to look at.

I understand that this hearing was called to a large degree to talk about governance. I happen to agree with Senator Carper, and I have said it before, as Senator Collins has heard, and my testimony reflects that the issues for the Board of Governors are not Democrat or Republican issues. Quite frankly, more than 8 years that I have been on the Board, there have not been partisan issues.

We have acted—tried to act in a very business-like kind of manner and I would think that the manner in which the Board is recommended in the Presidential Commission could result in a partisan Board, which is something I think everybody wants to stay away from.

I do believe there should be qualifications. I am concerned to some degree that the qualifications set forth in the Presidential Commission might be a little bit stringent. Many of us, including myself, Bob Rider, Ned McWherter, a former member of our Board, former Governor of Tennessee, Jim Miller, Al Casey, we have sat on public boards. I think that you would find that the Board, to a large degree, is constituted of extremely qualified people. On the other hand, I think you do have to set forth those qualifications.

And while we are talking about qualifications, if you are going to have a Postal Rate Commission which would have the kind of powers that are set forth in Senator Carper's bill, and Congressman McHugh's bill, you are going to have to have stringent qualifications for those people because you are really talking about people who will have immense power, which raises other questions.

I don't think you want to give them the kind of power that was suggested to a large degree in the report. I don't think you want to allow them to make determinations about the monopoly. Do you want to allow them to make determinations about universal service? I would say about 3 or 4 years ago, all I did was recommend that we should study the idea of 5-day delivery. When I testified on the House side, I thought I had committed a mortal sin. One of my fellow Governors, Alan Kessler, sat next to me and said to me—he had just gotten on the Board—he said to me, "David, the Republicans sound like Democrats. The Democrats sound like Republicans. I don't quite understand what is going on here." And all we did was say, study it. But I do think that is a major public policy issue and it is clear to me that Congress wants to have something to do with that.

So with that, I would say to you I will be more than happy to take any questions that you have and I look forward to entering into a dialogue.

I do want to take this opportunity to thank, as well, your staff. I know that your staff has worked diligently, all of your staffs have worked diligently on this issue and they should be—sometimes they are not thanked enough and I think they should be thanked, because they really have worked very hard, I know, to try to come to grips with what is a very complicated issue.

I want to take this opportunity also to thank publicly people from my staff, Bill Johnstone, particularly, the Secretary of the Board of Governors, John Reynolds, and Ralph Moden from Legislative Affairs, who have also worked very hard on this issue and we look forward to continuing to work with you. Thank you very much.

Chairman COLLINS. Thank you, Mr. Chairman.

Mr. Omas, I want to discuss with you the issue of the after-the-fact review of rates as recommended by the Commission. This is an issue that is critical in the whole rate-setting process, and I was very interested to hear your testimony that you believe an after-the-fact rate review was, I think you described it as misguided. I think your real views are even stronger than the word "misguided."

The current rate-setting system can take 18 months. It costs millions of dollars and it has engendered widespread opposition. Almost no one is happy with the current system. Part of the recommendations by the Commission were to establish the rate cap, but the other part to deal with the expense and length and the litigiousness of the current process was this after-the-fact review.

I can understand the concerns that have been expressed by you and by members of the mailing community that it could create chaos in the system if you after the fact reverse a rate increase or change a rate increase that the Postal Service under the cap has gone ahead and implemented. But if you have a before-the-fact review, which does seem like the logical answer to that problem, how can we ensure that it is going to be much more rapid, far less litigious, and far less costly than the process now. If it is before the fact, if it is before the rates go into effect, aren't we going to be trapped in the same process, or a process similar to what we have now?

Mr. OMAS. Madam Chairman, I don't think so. I think, as the legislation that was introduced by Mr. Carper and Mr. McHugh and the recommendations that have come from the President's Commission for more transparency and for more data collection and with the regulator having the ability to request and ask for more transparency and for data to request certain studies, I feel very strongly that an administrative review of the rates can be prompt. Right now, when the Postal Service issues a new rate, there is a time gap in between when it is approved and before it is implemented.

I think within that general time frame, it would be very easy to do an administrative review of the rates with the proper data. It would just be a matter of getting the proper information and plugging it in. If there is any question, we would do it. I am not espousing that this would be as long, as I said in my statement, as the trial-type hearings we have now. This would just be, basically be a paper process.

Chairman COLLINS. What kind of time period do you think such a review would take?

Mr. OMAS. I think it could be expeditiously done. Within less than 90 days.

Chairman COLLINS. That would certainly be——

Mr. OMAS. With the proper transparencies, what we are talking about is simply looking at the numbers and seeing whether their attributable costs are in place and whether or not the product is paying its way, as is now required by law.

Chairman COLLINS. Mr. Fineman, you talked about the truck backing up to the Postal Service and carting off a truckload of documents for the rate process. What is your judgment on the after-the-fact review versus a pre-implementation review?

Mr. FINEMAN. I don't agree with Chairman Omas. Let us try to create a new system here. There are two parts to this. There is one part where we are saying we are going to try to implement a price cap, and as a result of implementing a price cap, we are going to give a lot of power to a commission. Now, what is the trade here? What is the trade? The trade is that management be given a fair amount of flexibility within which to manage the Postal Service.

So imagine what the system is that we are creating now if we follow what Chairman Omas has indicated. We are going to have this price cap. Some sort of board, the Board of Directors or Board of Governors or whatever you want to call them—it doesn't really make any difference to me, quite frankly—that board from time to time, depending on what economic conditions are, will try to adjust rates within that cap, depending on what happens.

We get a spike in the price of gasoline. Right now, what happens in the real world when you get a spike in the price of gasoline for other people who are in our business, similar kinds of business? You get rate adjustments. What happens to us if we get a real spike, and it affects us in a real material way? We would have to apply for a new rate. I think it is unfair, and I use the word "we" and I shouldn't use that word because I am talking about it in terms of—I won't be on that board. I am talking about it in terms of what will exist.

What you are trying to do here today and you are trying to do through the system is give management the flexibility to manage within that price cap regimen. If you take it back, I think what you are going to have is another system of this give-and-take between people and creating some sort of adversarial system, which is really what you want to try to get away from. Have that adversarial system happen when you create the cap, not afterwards.

Chairman COLLINS. Thank you, Mr. Fineman.

My time has expired, but I can see that Mr. Omas is dying to do a rebuttal, so I am going to give you just one minute.

Mr. OMAS. I would simply like to say that I am in no way suggesting that we go back to a 10-month process. What I stated was that if proper transparencies existed, yes, we are going to assure—the Postal Service should have total and complete flexibilities to set their price caps within the regime. All I am saying is I think the public has a right to know whether or not the rate increase is consistent with the law, whether it was increased for fuel purposes or not. However, I feel that fuel should be a part of an overall business practice, as I mentioned in my statement.

If you are going to operate like a business, these are things that must be taken into consideration. In the private sector, I don't think things always go up and down because fuel goes up or electricity goes up. I think it ends up—that is good business practices, to take into consideration for those variations. But all I am saying is that we just would review. I am not asking for mounds of paper or I am not suggesting mounds of paper. I am simply stating that a pre-review would save a lot of people a lot of problems.

Let us say, for instance, and I won't take much of your time, that a rate does go into effect and then there is a complaint that the regulator must review and that review finds a defect in that rate structure. That means that all of the people who have prepared their computers, their mailing structures and everything to accommodate the new rate structure will have to go back. I mean, it doesn't make any sense. Thank you.

Chairman COLLINS. Thank you. I have many additional questions, but I am going to yield to my colleagues. We will do a second round of questions, just so that you all know, and perhaps even a third.

Senator Akaka.

Senator AKAKA. Thank you very much. I want to thank both of you for your statements.

Chairman Omas, your detailed written testimony certainly will assist us in drafting the Postal reform legislation and I want to thank you personally and your staff, who have always been available to help this Committee. I appreciate that dedication.

Mr. OMAS. Thank you, Senator.

Senator AKAKA. Chairman Fineman, I appreciate your guidance, as well, and I want to thank you for your nearly 10 years of service as a member and now Chairman of the Postal Service Board of Governors.

My first question is to Chairman Omas and is one that I have asked of several witnesses. Concern has been expressed that a price cap on Postal rates could become a cap on Postal compensation. Would you please share your views with us on this matter?

Mr. OMAS. Yes, sir. A major goal of Postal reform is to provide, I think, meaningful incentives that will encourage the Postal Service to be more economical and more efficient. Price caps, I feel, would achieve that goal.

I think as productivity increases under this more economical and efficient system, productivity would be rewarded with higher wages over a period of time. I think that they go hand in hand, and if the efficiency and the productivity come together, the employees will be rewarded for their productivity.

Senator AKAKA. Chairman Fineman, I was pleased that you raised the concern over the Commission's proposal that the President would appoint the first three members of the new board, who in turn will select other members with concurrence of the Secretary of the Treasury. I strongly believe that a modernized Postal Service needs more, not less, Congressional oversight, and removing the Senate's advice and consent role, I believe is wrong.

I also believe that the selection method raises serious constitutional questions and I asked the American Law Division of the Congressional Research Service to review this issue. Chairman Collins, if there is no objection, I would like to include in the record three CRS memos dated December 18, 2003, February 19, 2004, and March 31, 2004, that discuss this matter.[1]

Chairman COLLINS. Without objection, they will be included. I think that will be very helpful for all of us to read.

Senator AKAKA. Thank you very much.

Chairman Fineman, I believe the ideal governance design for a newly constituted Postal Board of Directors should ensure that decisions concerning the Postal Service can be made in an independent and transparent manner. This has been alluded to in your testimony.

My question to you is, do you believe the current structure provides independence, and what changes would you recommend?

Mr. FINEMAN. Let me begin by making a real personal comment and then I will, if I can, answer your question in some detail. All of us sitting here today, could we all agree, and I think we would, that the Federal judiciary, in essence, is extremely competent. I

[1] The memos appear in the Appendix on page 78.

mean, we would all agree to a large degree that the people who are sitting on the District Courts, and Court of Appeals are, and while there might be from time to time those issues that the U.S. Senate has with any individual nominee, but we would all agree to that.

I was nominated by President Clinton to be a Federal judge. It was near the end of his administration. I am one of those 60 people or so who didn't get confirmed at the end of President Clinton's administration. Having gone through that process, and I went through this process, I was qualified by the American Bar Association, met with the Department of Justice, met with the General Counsel's office in the White House, so I have had two FBI background checks, this one for this position and later for the Federal judiciary.

Was there any difference, and I have talked a lot about this with people in the mailing community, other people who are lawyers. Some of them have come to me and said, well, there is a vested interest in the Federal judiciary with the Justice Department, no matter who the administration is, to make sure that there are qualified people here.

I think that what you have to do is to set forth that those qualifications are for our Board so that you do get top-quality people, and then also have a review by the Senate. It is appropriate. It is a good check. It is appropriate, and I don't see that there should be any problem with that. We have to continue to have a bipartisan Board, as you have said, Senator, and we have spoken about this before. We can't make this into a politicized organization.

As to terms, we now sit for 9 years. The Presidential Commission recommended 3 years. I probably would say to you, having had experience, 3 years is on the low side because it is a complicated organization. Nine years is probably a little bit on the high side. I would say someplace in between would probably be appropriate.

There are recommendations in the Commission about age requirements. Most public boards today do have age requirements, and even the Federal judiciary, to become a senior judge at a certain period of time. They talk about 70 years of age. I think 70 is a little bit on the light side. I just saw, I mean, I always speak about the manager for the Florida Marlins. He took that team to the World Series and he was in excess of 70 years of age. So I think that probably you are talking about something, not 70 years of age, a little bit in excess of 70 years of age. That would be appropriate.

Those kinds of reforms, I think are appropriate for our Board.

Senator AKAKA. Thank you, Madam Chairman.

Chairman COLLINS. Thank you. Senator Carper.

Senator CARPER. Thanks, Madam Chairman.

You know, it is really very fortunate to have before us today people who served in these roles, and with Chairman Fineman, someone who has been around almost 8 years, or over 8 years, and is going to be stepping down and is sort of unencumbered because of that fact and can really share from his heart what he thinks we should do.

Let us back up just for a moment. Just explain to us, if you will, how the Board is currently constituted. Just run before us who nominates, how many people on the Board, ages that they can

serve, qualifications. Just take a moment and just give us that, please.

Mr. FINEMAN. Presently, the Board is constituted of nine outside directors, outside governors, and two who are management, the Postmaster General and the Deputy Postmaster General, no more than five of one party. There are no real qualifications that are set forth as a matter of statute other than there shouldn't be a conflict between ourselves and the mailing community.

I think that the prime things that the Board does, just to go a little bit further, is our selection of the Postmaster General, which is done by the appointed governors, and the Deputy Postmaster General is selected by the Board with the Postmaster General, and our ability to—and we, as a matter of statute, set rates.

Senator CARPER. Talk to us about the qualifications that we should put in the law.

Mr. FINEMAN. I think you have to have people who have sat, or have qualifications to be on a board of a major business. I mean, we would rank, I think, I don't know, if we were a business, I think No. 2 or 3. Wal-Mart has now surpassed us in the number of employees that they have. I think we are now second to Wal-Mart, and we keep decreasing the amount of employees, which is an admirable thing. Through the efforts, I think, of the Board and the Postmaster General, we are now a bit more than 700,000 or so employees.

You can't have people who have no business acumen whatsoever. But it is a public board. It is different from a private board. So people have to come to this Board with a little bit more than, I think, just basic business qualifications.

Senator CARPER. Talk to us, if you will, about the size of the Board. Should nine members, five of either party——

Mr. FINEMAN. My personal feelings, and they represent my personal feelings here, so I want to make that perfectly clear, I think that a board operates a little bit better with a smaller group of people, but not too much smaller, seven or so, because what we are talking here is different from a corporate board.

One of the things that you have done, all of you, in going through what have been the most recent scandals in corporate America, is you talked about having, making sure there are outside directors who are independent and creating the Board with more outside directors. Just think about this for a minute. We have a Board of almost all outside directors plus the Postmaster General, who we hire.

So it strikes me that kind of thinking isn't necessarily needed because we have all outside Directors. But I do believe that if we had a little bit of a smaller Board, it might be a little bit more manageable.

Senator CARPER. You talked about the length of the term that an appointee would serve on the Board, and I think the Commission's recommendation was a 3-year term?

Mr. FINEMAN. Correct.

Senator CARPER. A single 3-year term?

Mr. FINEMAN. I think you can be renominated. I don't have that in front of me.

Senator CARPER. I just don't recall.

Mr. FINEMAN. I believe you can be renominated. You can be renominated.

Senator CARPER. All right, thank you. We thank the audience. [Laughter.]

You are suggesting 3 years is a little short. I would be inclined to agree. The current term is what, 9 years?

Mr. FINEMAN. Correct.

Senator CARPER. That is a little bit long. I wonder, Madam Chairman, if there is some number that works between three and——

Chairman COLLINS. Five or seven might just be the answer. [Laughter.]

Senator CARPER. You never know. Maybe even six, I don't know.

Talk to us a little bit about the age restrictions. I think the Commission suggested 70. Is the Commission saying at age 70, the person would have to step down or they could not be nominated for another term beyond the age of 70?

Mr. FINEMAN. I am not sure about that. I think they have to step down at 70, which is not an unusual situation. I know that on some public boards—I see my good friend Senator Lautenberg has a smile on his face at this point. But I think that is——

Senator LAUTENBERG. I'm so interested in this subject. [Laughter.]

Mr. FINEMAN. I think that they have copied, to some degree, what occurs on some outside corporate, well, in corporate boards throughout America.

Senator CARPER. Mr. Omas, I want to ask you a question about the qualifications of the Board of Governors. I asked Chairman Fineman what he thought were qualifications that would be helpful and he gave us some ideas. I am going to ask you about the Commission, as well. But with respect to the Board of Governors, what kind of qualifications would you suggest we keep in mind?

Mr. OMAS. Well, I would——

Senator CARPER. To write into law?

Mr. OMAS. I agree with Chairman Fineman. I think that the Postal Service is so complex and it is, as Chairman Fineman said, next to Wal-Mart as far as a big business is concerned and it is multi-disciplined. I think you need people—I don't think you can actually say that someone should come in with an accounting background or with a statistics background. I think you have to find someone who has a good across-the-board knowledge of business, of government public service.

I think it needs a little bit of everything and I think I would go with Chairman Fineman in that I think it would be very difficult to specifically say exactly what qualifications one must have, and Mr. Carper, as we all know, the sad thing about some of the positions on the Board of Governors as well as the Rate Commission, it is not the most sought after of positions. So it would make it even more difficult to find people. If you started putting regulations, you might find that you are doing more harm than good. Again, that is my personal opinion.

Senator CARPER. On our next round, Madam Chairman, I would like to come back and with Mr. Omas ask really some questions about the structure of the Commission. Not now that my time is

expired, but I look forward to having a chance to ask you that in a few minutes. Thank you.

Chairman COLLINS. Thank you. Senator Lautenberg.

OPENING STATEMENT OF SENATOR LAUTENBERG

Senator LAUTENBERG. Thank you very much, Madam Chairman. I am so tempted to get into a defense of aging—— [Laughter.]

But I realize it is probably not the single most important subject for 95 percent of you in the audience.

Thanks very much to all of you, and you, Madam Chairman, for conducing this hearing. I think it is really important and I ask unanimous consent that my full opening statement be included in the record.

Chairman COLLINS. Without objection.

Senator LAUTENBERG. Thank you.

[The prepared statement of Senator Lautenberg follows:]

PREPARED STATEMENT OF SENATOR LAUTENBERG

Madam Chairman: Postal reform is an important national issue, but most Americans spend little time thinking about it because they take postal service and the employees who provide it for granted.

The importance of the U.S. Postal Service (USPS) to our national economy cannot be overstated.

I'll give you an example: A 2-year delay in postal rate increases has the potential to save publication companies like Time Warner approximately 200 million dollars in mailing costs.

Last year alone the USPS delivered more than 200 *billion* pieces of mail. So the important role the Postal Service plays in our economy and the contribution of its 843,000 dedicated employees should not be overlooked or taken for granted.

Having said that, this is indeed a time of great change for the Postal Service.

As the President's Commission has observed, mail is "migrating" to cheaper Internet-based alternatives even as the Postal Service's delivery network expands at a rate of 1.7 million new addresses per year.

Given the existing regulatory structure, the Postal Service's debt is likely to increase *every* year, making it tougher for the Postal Service to achieve its fundamental mission of universal service.

Accordingly, it is clear that the Postal Service needs to become more efficient and more effective in fulfilling its universal service goal.

Having said that, I'm at a loss to explain how we expect the USPS to become solvent by making it responsible for picking up its workers' and retirees' pension benefits that are attributable to their *military service.* It is *patently unfair* to shift 27 billion dollars of pension costs associated to military service from the Department of Treasury to the Postal Service.

As the Presidential Commission on Postal Reform recommended, the administration and Congress should return responsibility for paying these benefits to the Treasury Department which, until recently, paid these obligations through annual appropriations.

With regard to other matters, I support the Commission's recommendation to make the rate-setting process less cumbersome and more efficient. Today, the process can take upwards of 10 months; the Commission's recommendations would reduce the rate-making process to 60 days.

I am also intrigued by the notion of increasing work-sharing and private sector partnerships. I would hope, however, that such partnerships are not *at the expense* of the hardworking men and women of the Postal Service. Improving the Postal Service should not mean *gutting* its workforce.

Today, I look forward to hearing from Chairman Omas of the Postal Rate Commission and Chairman Fineman of the Postal Board of Governors—the two ranking Postal Service officials who will be tasked with the responsibility of implementing the postal reform measures that we pass.

I am interested to hear our witnesses' views on the Presidential Commission's recommendations and any other postal reform ideas they wish to share with us.

Thank you, Madam Chairman.

Senator LAUTENBERG. Some of the questions I raise, I understand have been or are in the process of review, and that is how military retirees get treated and so forth. We will leave that to the review that is underway.

I can't help be somewhat amused by the discussion about how many sit on the Board and the members' particular qualifications because if we want to act like a board of directors of a regular business, that is the environment I came from. I ran a pretty large company, was the creator of the company, that today employs over 40,000 people. When I look at regulations regarding age and so forth, I wish that we could have an electronic competency test, although I am afraid that we might have problems within the institution here—— [Laughter.]

And then we could push a button and see, well, say this guy is older, having just passed my blank birthday, but the people of New Jersey decided that despite the fact that I was in my senior status by a large measure, that they wanted me to come back here and represent them, and I was very much pleased to be able to do that.

So as you look at the composition of a board and say, what should it look like, I agree that there ought to be some consideration for limiting age. Mr. Fineman, what happens in the Federal courts when someone reaches, is it 70?

Mr. FINEMAN. They reach a senior status——

Senator LAUTENBERG. Senior status, which means they continue to function.

Mr. FINEMAN. They continue to function——

Senator LAUTENBERG. And their opinions continue to be respected and implemented. So perhaps we can drop that one. Maybe the ones who ought to be age limited are those who have the heavy pack on their backs and are worn to a frazzle by the heavy load.

I hope, Madam Chairman, that one of the things that can be done with a degree of expediency is to examine what the mission is. What should the Postal Service be like? Seven-hundred-and-fifty-thousand or so people employed, good, loyal employees, work hard every day, go out in the most miserable weather imaginable, and it is getting more miserable by the day. What do we want to provide? When I think of the expression commonly used that it should look more like a business, well, which business? Like Enron or one of those, or should it be like a business that has more impact on how the process works?

Like the time that we chose to move 28,000 employees out of baggage screening at the airports because we needed a higher degree of comfort about the efficiency and the manner in which they work, so we said, we are going to take them right out of that business world and we are going to put them in the world of government where that can be regulated and understood and make sure that they are trained properly.

So it is kind of the obverse, if I can use that term, to that which we hold out as a model, Mr. Omas, and I know how hard you have had to work to weave your way through the network.

There is a question about whether or not the Congress ought to be more involved. Well, the Congress has been very much involved for one heck of a long period. There isn't a person who serves here or in the House that doesn't have a Postal concern. You want to

arouse the ire of your constituents, tell them you want to close the post office that has two employees and you know Jack and Mary. Well, heck, they have been here a long time. You have to decide, I think, a set of conditions that describe exactly what we want the Post Office to do.

You are right, gasoline prices go up. Everybody is getting a boost, the airlines, etc. The Post Office must swallow hard and keep walking and it can't be that way.

Can we do something, I ask you, by way of establishing a review—it has probably been attempted a dozen times—that really details what we ought to do? Is there such a thing, a combination with the private sector and the Post Office?

We ran into a problem in New Jersey. Mine is that I am running out of time. I will be brief with this. But the problem was that we had bus routes, a lot of them that were run by private companies. They didn't like those routes, and then automatically the State inherited or the community inherited those bus routes. It is not different than the Post Office. It is a government service that people rely on that has helped build this great country of ours by knowing that there was a reliability of communications.

Well, that world has changed and now how do we adapt? Does the Post Office get a chance to pick up part of that business? Are we involved in the electronic side of the communications arena in any way? I think those things all have to be considered.

I have used my time, Madam Chairman, but I hope that if anyone wanted to respond, that you would allow them to do it. Is there another approach that we ought to be taking altogether instead of simply, and I don't demean it, instead of simply saying, well, here is the number of directors and here is what they ought to look like. What is it that the mantra ought to be, the mantra for the Postal Service in this country?

Chairman COLLINS. You may answer. Go ahead.

Mr. OMAS. Senator, that is a tough one. I think the Presidential Commission tried to address some of those things. I think one of the things inherent whenever you look at an existing government entity, you sort of tend to look at what the structure is and how you can improve the existing structure. I see exactly what you mean. I don't know that anyone has ever gone out of the ballpark to see if there is any other meaningful way to reform the system.

I guess no one has ever given it really any consideration. I think you have brought something to light here that we never looked at. I think we have always looked at improving what we had, and I think that is what we are attempting to do here with this reform. But I think it is thinking like that that will contribute to the people making the decisions doing the right thing for the Postal Service when we get to that end.

Mr. FINEMAN. Senator, what I think that you were saying is that when we talk about the Postal Service, there are great public policy issues here, and it seems to me that those public policy issues, to a large degree, rest with you, the elected officials in this country.

So if I can take a step back a little bit where we have talked about creating a Postal Rate Commission, what I would not want to see happen is that a group of people appointed and confirmed by the Senate then make decisions which are public policy deci-

sions. I think that is what you were elected to do and I would hope that when you consider a statute, consider enacting new law, that you will understand that your responsibilities include the responsibility of determining what is universal service and whether we should continue to have uniform prices. That is your responsibility, not the responsibility, I would suggest, of what might be the Postal Rate Commission.

Senator LAUTENBERG. Thank you.

Chairman COLLINS. Thank you, Senator.

Mr. Omas, many of our previous witnesses, including Treasury Secretary Snow, members of the mailing community, Postal competitors, the GAO, have testified that the Postal Service's system for allocating costs is not transparent and at times that it is based on faulty or obsolete data. One advantage of the old too adversarial rate-setting system is that those issues tended to surface.

For example, I am told that there was a rate increase that was once proposed for in-county newspapers. There was going to be a 34 percent rate increase. During the rate proceeding, it came out that it was based on inaccurate data. Now, that error was uncovered during the rate case, but under the new system we are talking about, we are not going to have these lengthy adversarial proceedings and that is why the review issue becomes an important one.

But putting the issue of whether you do the review before the fact or after the fact aside, what steps do you think the Postal Service can take to increase the transparency of its financial data and to ensure that the cost allocations are more accurate than many observers believe them to be at present?

Mr. OMAS. Madam Chairman, as you probably know, right now, that is one of the things that becomes very important in a rate case. We look at attributable costs and we look at causality, and whatever causes costs can be attributed to that particular piece of mail, we attribute that.

I feel that with better transparencies, and if the Postal Service focused more on the causality of what the various classes go through, I think we can have a better sense of and focus more on what should be attributed to what class of mail.

Chairman COLLINS. The Presidential Commission said that it declined to prescribe a specific target for cost attribution, but it criticized the Postal Service's attribution level as being far too low. Right now, I believe the Postal Service attributes 40 percent of the costs to institutional costs. Secretary Snow at our hearing also said that he thought that was not an appropriate level.

Can the Postal Service do a better job at this, since it is such a critical issue, and if we can't count on the Postal Service to attribute costs in a more precise way, who should make those decisions? I mean, is that something that you see the Regulatory Board being responsible for?

Mr. OMAS. Yes, I do see the Regulatory Board being responsible for that, and here again—I hate to sound like a broken record—we just go back to transparency, transparency, transparency. If the figures and data studies are there, we know how to attribute it, we have ways of, I mean the Postal Service and the staff at the Rate Commission, research staff, have found ways of attributing the

costs of the mail, of what causes mail costs. I feel with the proper data that can continue and we can do a better job.

Chairman COLLINS. There is widespread interest in putting into this legislation a price cap. What do you think is the proper role of the new Regulatory Board versus the Congress in establishing the cap, the inflation component, and the productivity index?

Mr. OMAS. I strongly feel that the Postal Service should have the flexibility to set its prices, and I think the legislation allows 24 months, which would be a super rate case. I think at that time, we would be able to work out with the mailers, with the stakeholders, with the Postal Service and the regulator exactly how that would be addressed.

Chairman COLLINS. Mr. Fineman, do you have any observations on the appropriateness of a cap, how much we should specify in the law, how much we should leave up to the Postal Service, and what should be the responsibility of the Regulatory Board?

Mr. FINEMAN. I believe that your legislation should identify what that cap is. I strongly believe that. I think there is too much risk here in having what I would call real soft cap language which would allow the Postal Rate Commission to set what would be the cap. I think that in a system like this, what you would end up having is a considerable amount of lobbying back and forth in this most important issue.

I think you are going to have to come to grips with—there is a fair amount of literature that is written already about cap regimen and the real issue here, I think, becomes that most people have identified the cap using some sort of CPI index over many years. And why have they done it? If you go back, it kind of has a little bit of a historical bent to the telecommunications industry. That is basically where this CPI comes from.

And the real question now that I think the Postmaster General put out at the last hearing is that with the labor-intensive business that we have, can we, if we look at just the last 3 or 4 years—obviously, if you looked over the last 20 years and you used the CPI as the number, you would come to the conclusion that we can manage within a CPI environment plus a total factor productivity index.

You could probably manage within that, because if you looked over the last 20 years, what you saw was inflation went way up during periods in the 1980's, as an example, and now we have these very low inflationary numbers. So the real question is, if the country continues to operate under its present economic environment, can business run with a cap that is set under CPI, and I think that is something that you all are going to have to come to grips with.

Chairman COLLINS. Thank you. Senator Akaka.

Senator AKAKA. Thank you. I want to ask for more specific responses. The Chairman has alluded to outdated and inaccurate data that has been used. Chairman Omas, in the most recent rate case, the 2001 case, some delivery costs were still being attributed to data from the 1980's, which had long been recognized as obsolete by all parties, including the Postal Service.

Specifically, what expanded authority do you need to ask for cost studies on an ongoing basis to ensure that accurate and up-to-date information is used to attribute to Postal costs?

Mr. OMAS. Yes, Senator, I do support giving the regulator that authority. I think that authority—it should be essential that the regulator be able to direct the Postal Service to collect and analyze data. As I said before, a lot of times, and this case is a prime example, everyone knew that it was obsolete but we still had to use it. Had we had the authority to ask the Postal Service or to direct the Postal Service to redo a study, then that information would have been forthcoming.

And to expand a little bit further, I think that not only should the regulator have the ability to ask for these studies and to request other analyzed data, it should also have the ability to subpoena the Postal Service in instances where we have found that the data that was presented to us was not sufficient.

Senator AKAKA. Chairman Omas, in your comments you have used the words "unchanged" and that the Postal Service is very complex, which adds to the difficult task before us. Transparency seems to be something that we need to focus on.

Current Postal reform efforts are focusing on giving the Postal Service management greater flexibility while increasing its transparency. And again, specifically, what authority would a regulator need to ensure there is sufficient transparency to guarantee that the Postal Service does not abuse its new authority and to assure that all classes of mailers are protected from discriminatory or unjustified rate increases?

Mr. OMAS. Again, Senator Akaka, I think that both the Senate bill and the House bill address that issue by giving the regulator the authority to ask for studies and direct the Postal Service to collect data and analyze various data that the regulator would request. They also gave the regulator the subpoena authority.

Senator AKAKA. Chairman Fineman, I have long worked on the need for greater financial transparency within the Postal Service. As I noted in my statement, the Commission found that financial reporting has not always provided a clear picture of the Postal Service's fiscal condition. I was pleased, however, when the Postmaster General and the Board announced that the Postal Service will transition its financial reporting to standards set by the Securities and Exchange Commission for publicly traded non-stockholder-owned companies.

Could you update us on this transition, especially with regard to developing financial statements and disclosures comparable to those provided by publicly traded companies?

Mr. FINEMAN. I would say about 6 months ago or so, maybe a little bit less, we began to work closely to try to do exactly what you stated in your question, and we have to date begun to post on our website information on a monthly basis and we have recently entered into dialogue with the SEC, appropriate staff people of the SEC, so that we can determine exactly how we can file whatever has to be filed. We have worked with outside counsel, securities counsel, and with our outside auditors at Ernst and Young to determine exactly how we can transform, in essence, our reporting that we presently do so that it complies with SEC requirements.

I do want to add one other thing about this transparency issue, and I alluded to it in either a question I answered or the opening statement that I made. The present system that you have, and I think that if there is concern about transparency, the present system you have creates, in my opinion, what is an adversary system as to how we set rates. You, in essence, have a trial before the Chairman and the other Commissioners.

So let us step back for a minute and say, what is that trial? What happens there? What usually happens? Why are we taking all of this time? Who are these people who are intervening?

In my experience, what I have seen in the industry, quite frankly, is that there are two sets of people. There is a large part of the mailing industry who are trying to get rates as low as possible. We all would do that, right, if we were in their business? You want to keep the rates as low as possible because that is a cost that they have.

Then there are a bunch of other people who are somehow identified to some degree as competitors, and sometimes they like to get the rates as high as they can be. Why do they want the rates high? Because then for their competitive product, they probably can charge a higher rate.

Now, that is reality. I don't know if anybody has come here before to talk about that and say that is what happens, but I can say to you that is the reality of what occurs. And you go through this long adversarial system and we are asked to come forth with all kinds of studies. The Chairman and I have done something which has been extremely innovative. We have, for the first time, over a series of meetings, brought together our staffs and our Boards to have joint meetings in which we ask our staffs to supply us with certain information and studies that are done.

These issues about attributable costs are extremely complicated. People at the Postal Service could have one view. Outside people could have another view about what are attributable costs, so could people at the Postal Rate Commission. Professors spend their lives writing papers about attributable costs. It is not an issue that is just real easy to come to grips with. There are vast studies about it.

The last thing I wanted to comment about is this idea of cross-subsidization. I mean, the Postmaster General at the last hearing stated in no unequivocal terms that there is not cross-subsidization. I believe there is not. Quite frankly, that is an issue that is litigated for 10 months or so before the Postal Rate Commission. That is a major issue that is litigated over and over again before the Postal Rate Commission, and there is an appellate process. In other words, there are a long series of cases that we could go to in these courts of appeals where various people take the appeals about this kind of issue.

I would say to you that I don't believe that there is cross-subsidization. Are there institutional costs that are spread across various classes of mail? Sure.

Chairman COLLINS. Thank you. Senator Carper.

Senator CARPER. In my first round of questioning, I asked principally Chairman Fineman to help us with respect to the structure of the Board of Governors of the Postal Service from the Board

side. Mr. Omas, I want to do a similar kind of thing with you with respect to the Commission. Just take a moment, if you will, just lay out for us currently how the Commission is created.

Mr. OMAS. Well, currently, the Postal Rate Commission consists of five Commissioners, three of which are of one party. We at present only have four Commissioners. We are waiting for a fifth to come. We serve a term—each of the terms are staggered so that there is never complete, total vacancy at one time. We serve a 6-year term with what we call a follow-up year, which is 7 years. In other words, that means if the White House or the Senate decides that they want to appoint someone at the end of my term, they would appoint—as my term expires, I would have a year to stay while you are deciding who the new person would be or whatever.

Senator CARPER. And if during the course of that year, a successor were confirmed, then that person would——

Mr. OMAS. I would step down, absolutely. That is the present system. There are five of us.

As you know, the President's Commission recommended that there be a Postal Regulatory Board composed of three members. I personally—and here again, this is personally me—I think that would be a mistake and I will say the reasons why I think it should be at least five members is, as Chairman Fineman stated, we are a totally bipartisan Commission and I don't think politics comes into play there.

But with a three-member Board, it could become very politicized. You could end up with two Democrats or two Republicans. There could be a vacancy opened where that is a Democratic vacancy and the Republicans would have control. Someone could get sick. There could be a major complaint that needs to be considered and you have one vacancy, you have one person out sick, you don't have a quorum to meet.

So I think I will probably be out of the picture, so I am not looking for myself. Like Chairman Fineman, I am coming to, in a couple of years, the end of the road for the Commission. But I strongly believe that it—and your bill and the McHugh bill leaves the Commission with five members. I strongly believe it should continue to be five members because of those reasons.

Senator CARPER. Does current law provide for political balance among the five members?

Mr. OMAS. Yes.

Senator CARPER. Do you recall what the Commission's recommendations are with respect to political balance. I think they retain it, don't they?

Mr. OMAS. The Chairman of the Commission, of the Board, would serve at the pleasure of the White House. It is similar to what it is right now.

Senator CARPER. That was not my question. My question is, with respect to political balance, what are the Commission's recommendations?

Mr. OMAS. I don't recall. It would still be balanced as it is now with——

Senator CARPER. It is interesting, because in the Board of Governors, there is no similar recommendation. We can end up with

a Board of Governors that would be entirely of one party or the other.

Mr. OMAS. Absolutely.

Senator CARPER. And in a three-member panel like that—the comments of Chairman Omas are helpful here. In a panel of three members, two of one party and a vacancy in the third member, we would end up with a situation I don't think would be very helpful.

In the legislation that I have introduced, and similar to what Congressman McHugh is going to introduce, we called for investing in this new Postal Rate Commission, we make it a Regulatory Commission, the authority to formulate service standards, such as frequency of delivery, speed of delivery, that kind of thing.

If you will take just a moment and talk about the Presidential Commission's recommendations vis-a-vis the role, the powers of your Commission going forward and compare them with what we have included in our legislation and just take a moment to, if you had to sort of pick and choose between the two different approaches, they are broader than we are with respect to investment of power. What is the right balance here?

Mr. OMAS. Well, one of the things that I feel very strongly about is the President's Commission recommended post-rate review. I would recommend at least an administrative review before rates are implemented.

Senator CARPER. Say that one more time, please.

Mr. OMAS. The President's Commission recommended a post-rate review. In other words, the Postal Service could implement rates and it would only be after the fact that if a complaint came from a mailer, a utility mailer or whatever, that we would be able to entertain that complaint. But as I told Mrs. Collins earlier, I oppose that because of what it can do—having to go back after the fact, after they have been implemented. The President's Commission recommended that it be a post-rate review. Your bill did not address that subject.

Your bill kept the Commission, the Regulatory Commission, as a five-member board. I would support that. I support the subpoena power and the ability to direct the Postal Service to conduct studies and analyze data. Your bill gives us some ability, whereas the President's Commission gives the Rate Commission total and complete review over the monopoly and the universal service.

I feel that, basically, your bill, it strikes a better—yours and the House bill strikes a better balance in that you would still control some oversight but yet we would determine periodically what the service standards are. And I think the big thing here is, is the Postal Service meeting service standards. One thing is that most operators do not define their monopoly or have decision power over their monopolies. Therefore, that is why I think some of the public policy issues involved in the monopoly and the USO should be kept by Congress with a review by the regulator.

Senator CARPER. Mr. Sharfman, do you agree?

Mr. SHARFMAN. Absolutely. The key issue that we see, though, is in who interprets the laws passed by Congress. Currently, the Postal Service interprets what is consistent with the private express statutes and it claims the authority to determine what the extent of the monopoly is. We believe it would be better if a neutral

third party, in this case the regulator, would consider complaints as to whether the monopoly is being violated.

Senator CARPER. Thanks, Madam Chairman.

Chairman COLLINS. Thank you. Senator Lautenberg.

Senator LAUTENBERG. Thank you, Madam Chairman.

I am curious about a couple of things and perhaps I can get a better understanding here. The question was raised by Senator Akaka about the SEC requirements. Now, the replications of the corporate world's requirement, the 10–K and the 10–Q, they are the same requirements?

Mr. FINEMAN. That is exactly what we are trying to come to grips with right now. There is no statutory requirement that we do this. We are trying to voluntarily comply with exactly your issues, the 10–Qs and the 10–Ks. The question becomes what are significant events that we are going to have to report on a regular basis?. What are those monetary thresholds as to what might be a significant event?

Those issues are issues that the Board, and we are going to confer with the SEC, might be appropriate for us to report on a regular basis. They are the hardest issues that a publicly-traded company has, as well, to try to figure out what is an appropriate 8–K requirement. So we are going to try to come to grips with that, and I suspect we will have that fully completed within the next few months. At least before I leave this Board, which is in December.

Senator LAUTENBERG. That could be your legacy, get your picture on the front cover. Would it constitute an annual report? I mean, there is no constituency body as we know as shareholders.

Mr. FINEMAN. We do issue an annual report, and I would say that annual report is extremely comprehensive. I mean, from time to time, there might be criticism from some outside people of that. I think that the real criticism that I have seen deals with how we report about costs and cost allocations. Some people have criticized that we are not adequate in our reporting of cost allocations, but we do issue a pretty comprehensive annual report that I think has won all kinds of awards vis-a-vis government, at least. I think to a large degree we are trying to be as transparent as we can.

Senator LAUTENBERG. What is the distribution of the annual report after FedEx and UPS?

Mr. FINEMAN. We distribute it to thousands of people who get a hold of it, I can assure you of that, and I think your office, as well as every other office on Capitol Hill.

Senator LAUTENBERG. It is a limited distribution. Does the Post Office, and I obviously have not looked through this—as a matter of fact, I have not seen it, very frankly, before—are there capital costs in the—significant capital costs? What kinds of things? Are we talking about property, buildings, etc.?

Mr. FINEMAN. Capital expenditures are significant. The Board presently reviews every capital expenditure in excess of $10 million. The Commission was a little bit critical, saying that was on the low side. We have been having our Capital Projects Committee review that presently. I don't think that anybody at the management level would indicate that by having that level of review, we are in any way hampering their ability to go forward with capital projects.

I mean, in our area, Senator Carper and myself and Senator Lautenberg—I am from Philadelphia, so now we are building probably one of the most significant plants that exists now outside of Philadelphia at a juncture between I–76 and I–95. The Postal Service is going to have to revamp its network over the next few years.

One of the reasons we have to do it is places like Philadelphia are indicative, where you have an old WPA plant that was built next to the railroad tracks in Philadelphia. The same thing exists in Chicago, L.A., all over, because we carried mail on the railroad trains. Now, we do it mostly on interstate highways and by——

Senator LAUTENBERG. How do they account for the expenditures for these capital projects? Are they on a cash basis or——

Mr. FINEMAN. There is a capital budget, a 5-year capital budget, and everything is basically on a—everything is really on a cash basis here.

Senator LAUTENBERG. Right.

Mr. FINEMAN. One of the issues I think that you might be alluding to here is one of our real problems over the years, as I have seen it, is that there is no reserve—we can only have debt. We have a $15 billion ceiling on debt. We borrow from the Treasury, exclusively from the Treasury. But there is no capital here. We can't go to the public sector and go get capital to go do things of this sort.

Senator LAUTENBERG. Why wouldn't it make sense—do we try to substitute leases and call on the private sector to pick up some of the capital obligations that we have, because as I understand it, and again, correct me if I am wrong, overall, there is a pretty good, I won't call it profit, but there is a pretty good revenue return from normal operations and that it is only when it gets to the capital side or to the fixed cost side, let us say for the pension liability that we talked about, that is what creates the biggest problem for the Post Office. Borrowing is, in fact, a subsidy in a way, and I don't know why we differentiate there.

Mr. FINEMAN. I think this Board particularly, and I take my hat off to former Governor McWherter who worked very hard to keep our debt as low as possible. Actually, I think last month, for the first time in the history of the Postal Service for some period of time, we were actually debt-free for about a day or so. Then obviously we had to borrow to make payroll and things of that sort, just like any normal business would be run.

We are probably one of the largest leaseholders, tenants, in the United States. Many of our facilities are leased and we have looked at opportunities where that provides a good return for us.

Senator LAUTENBERG. One last question, if I may. Mr. Omas, do you know there is a wonderful pen made in Italy called the Omas?

Mr. OMAS. Yes, sir.

Senator LAUTENBERG. It is very expensive, too.

Mr. OMAS. Very expensive, and my family is from the Dalmatian Coast and I have been trying for years to figure out whether I am kin to them.

Senator LAUTENBERG. That is very interesting. Do you believe that the Postal Regulatory Board will be in a decent position, or in the appropriate position to determine Postal employees' pay comparability?

Mr. OMAS. No, sir, I don't think we have the expertise. I mean, obviously, if Congress decides that the Regulatory Board should take that on, I am sure that we would have the ability to find the proper people and staff it in the proper way. But if you were to ask me that with the present staffing we have, I would say no.

Senator LAUTENBERG. Thanks, Madam Chairman.

Chairman COLLINS. Thank you, Senator. You just asked the question I was planning to ask Chairman Omas.

Senator LAUTENBERG. About the pen? [Laughter.]

Chairman COLLINS. Not about the pen, though I would like one of those pens, I hasten to say. [Laughter.]

I think that the Presidential Commission's recommendation on having the Board look at the wages is not one that we should incorporate in our legislation, but I am glad to get you on record on that. I already knew Chairman Fineman's opposition to that proposal and I appreciate your asking the question.

I do want to clarify, however, on the exchange between Senator Lautenberg and Chairman Fineman that the Postal Service's debt and liability picture is anything but rosy. The unfunded liabilities for retiree health benefits, for workers' compensation, are literally in the tens of billions of dollars. I don't want to leave this hearing record with the impression that the Postal Service is "debt-free." In fact, it is——

Mr. FINEMAN. The real question—I mean, obviously, the unfunded liability is a real problem. That is why we are here.

Chairman COLLINS. Right. Exactly.

Mr. FINEMAN. As a practical matter, that is why we are here. We can't—under the present system, we are not going to be able to fund those liabilities as we see a decline in First-Class Mail and an increase in delivery points.

Chairman COLLINS. I just wanted to make that clear for the record, because I believe that if we do not act to pass comprehensive reform, that the GAO is right in predicting a death spiral for the Postal Service and we cannot allow that to occur. It is too vital to our country and to the nine million people whose jobs depend directly and indirectly on the Postal Service.

Mr. Fineman, let me end my questioning with one final question to you, and that is part of our challenge in drafting this bill is going to be to figure out what is appropriately the duty of Congress, and I agree with your comments earlier that defining the monopoly and universal service are public policy questions that should be answered by Congress. But defining the responsibilities and the authority of the authorizing law set by Congress versus the Postal Regulator versus the Postal Service is going to be a very challenging and important task.

Could you give us any guiding principles in this area to establish the appropriate balance between the authority and the responsibilities, particularly of the regulator and the Postal Service?

Mr. FINEMAN. One of the concerns that I had a little bit with my friend Chairman Omas's comments is that what you do not want to have happen is when you have this new legislation, and I think I have made reference to this before—I consider it a trade, and the trade becomes there is going to be more oversight from a Postal Regulatory Board, or the PRC, whatever you want to call it—there

is going to be more oversight and the trade will be that management will have more flexibility.

That is the deal here, and you have got to make sure—because if you saddle management, it seems to me, with less flexibility and you continue to have more oversight, then we haven't accomplished anything. What we are trying to do is, and I think that is the struggle here, is to create the appropriate balance, to make sure, because there is a monopoly. If there wasn't a monopoly, I am not sure we would be talking about all of this.

But because there is a monopoly, we want to make sure that there is the kind of oversight that the American public is entitled to have. At the same time, you want to allow management and the Board to be able to run the business as a business and not be saddled with a bunch of bureaucratic regulations.

Chairman COLLINS. Mr. Omas, do you want to add anything to that?

Mr. OMAS. Well, I think that because the Postal Service is a public entity that there should be some type of oversight. I don't think that Senator Carper's bill, or any of the things that have been in the McHugh bills, the Carper bill, or even the Presidential Commission's recommendations, say that we are taking away existing flexibility.

But the one thing—I come from the point that the Postal Service is a public entity. It should run like a business and should be self-financing. But I also think, because public policy does become involved, because they do have a monopoly and there are competitive products out there that they compete with, that there should be a certain amount of oversight.

I am not intimating that there should be—that we should go back to the 10-month hearings or this or that or the other. What I am saying is that, or what I feel very strongly, that because of the monopoly and the USO regulation, the charter for universal service, that Congress, along with the regulator, should set the guidelines. As to what they feel that the Postal Service should accomplish or should not accomplish on service levels.

And all I am saying is that there should be an ability to review and to ask for studies. I am saying ask for a study that will help evaluate, are they producing? Are they delivering universal service? Are they abusing the monopoly and cross-subsidization? That is the only thing that I am suggesting—that is where I am coming from.

Chairman COLLINS. Thank you. Senator Carper.

Senator CARPER. Whether we would adopt the approach suggested in the McHugh bill, my legislation, the President's Commission, the regulatory body—now we call it the PRC—your job is going to change. The nature of your job is going to change, whichever those approaches or combinations that we choose.

I am not, frankly, familiar with the kinds of resources that you have now, what the five Commissioners have now to rely upon to enable you to do your job. I would say, Madam Chairman, that regardless of which of these approaches we take or some combination thereof, your job is not going to be easier. It is not going to be diminished. If anything, it is going to be enhanced.

I guess my question is, how can we make sure that you have the resources that are necessary to enable you to do your new job well?

Mr. OMAS. I think one of the determining, or one of the things that the bill allows us—both your bill and the McHugh bill allows us 24 months within which to make various decisions, to develop regulations, rules, practices, how we approach whatever we are told to do. Once we have made those decisions, I think at that time, we would need the ability to hire consultants and have extra expenditures to bring in the staff, and it would be after we go through that and we set up how we would approach issues, and how we would regulate, and what we would do that we could determine what resources we will need.

But yes, sir, we would definitely need to expand the staff. I don't know that the commissioners would need additional staff. I think we would need additional research economists, in some instances attorneys, to get the job done.

Senator CARPER. Do I understand that the President's Commission has recommended that the new rate system go into effect after using the current system one more time?

Mr. OMAS. That is correct. That is the 24 months I just referred to—that is when the parameters for the rate caps, etc., would be set, and one of the things that I will address that Chairman Fineman said earlier about the rate caps, we would set an original rate cap, but that does not prevent us from going back periodically to review that rate cap and either increase it or whatever.

Senator CARPER. Chairman Fineman.

Mr. FINEMAN. Yes, I just wanted to comment. It seems to me that—we are not here to hold a hearing about the military pension and the escrow matter, but I think to a large degree that is going to have an impact upon this whole calendar. The real question is going to be, for how long are we going to be able to hold rates stable? And the issue is going to be, to some degree, what happens with the escrow provisions in the military pension. Then if you pass a piece of legislation, how long will it be until there really is a necessity to do something?

You are going to have some period of time where we are going to have these discussions with a new—I am assuming we pass legislation—with a new Commission as to the setting of the appropriate rate. But I think if we are going to look at a calendar, some impact is going to happen as a result of what happens here with the escrow provisions and the military pension.

One further comment, if I can, because you talked about this. It is one of the reasons that I tend to believe that if you are going to have qualifications—and we are looking way out into the future now—of the Rate Commissioners or whatever you might call them, is if we don't have, with the kind of power that you have in your bill and Congressman McHugh's bill, if we don't have those kind of qualifications of economists, lawyers, statisticians, accountants, and people who have had experience in dealing with this kind of environment, people maybe from the FTC, FCC, places like that, what you are going to have is a Commission that is going to be very staff-driven, totally dependent on staff, because we are talking about a very complicated system here. So it is a reason why I both think there are qualifications for Board members as well as quali-

fications for the members of what might be the Postal Regulatory Board.

Senator CARPER. Madam Chairman, It looks like my time has expired. It seemed to go so quickly, more quickly than usual.

Chairman COLLINS. That is because your questions were unusually good, or—— [Laughter.]

Are they always that good?

Senator CARPER. Unusually vague, perhaps. I don't know. [Laughter.]

I have a couple other questions I might submit in writing. I just want to say to our witnesses today, especially Mr. Sharfman over there, I could just barely see your lips move when the other witnesses spoke. [Laughter.]

We appreciate your being here today. This has been a very helpful back-and-forth. To Chairman Fineman, thank you for your extended service. Chairman Omas, thank you very much, as well.

Mr. OMAS. Thank you.

Chairman COLLINS. Thank you.

I want to join Senator Carper in thanking our witnesses not only for their testimony today, but also for the advice and the insights that they have shared with me and with the Committee staff.

I do want to thank Ann Fisher on my staff. She has worked very hard in putting together these eight hearings that we have held to make sure that we did an in-depth review of the Commission's recommendations and heard from a wide variety of stakeholders.

Now the hard part begins. Senator Carper and I seek to draft a bill and get it introduced at the end of this month. We are trying to keep on an aggressive time table because we are committed to getting Postal reform legislation enacted this year. I think the Commission's recommendations and the Postal Service's financial straits demand that we take advantage of this opportunity to act this year.

This hearing record will be held open for 15 days for the submission of any additional materials.

I again thank you very much for your testimony. This hearing is now adjourned.

[Whereupon, at 12:03 p.m., the Committee was adjourned.]

APPENDIX

PREPARED STATEMENT OF SENATOR FITZGERALD

Good morning. I am pleased to join my colleagues today as we consider proposed reforms to the U.S. Postal Service regarding its rate-setting process and governance structure. Chairman Collins, Senator Carper, Senator Akaka, and other Members of this Committee have worked tirelessly on the important issue of postal reform, which affects each and every individual residing in the United States. With their leadership and concerted efforts, we may achieve substantial reforms that will help the U.S. Postal Service meet its current and future challenges while continuing to serve as a vital link in the Nation's communication network.

The U.S. Postal Service (USPS) is a unique institution that has provided an invaluable service since its inception. Its size and impact throughout the Nation is tremendous. The Postal Service has over 830,000 employees nationwide, over 43,000 of whom are in my home State of Illinois. The Postal Service also operates 2,079 postal facilities in my State. It is a $67 billion enterprise—making it the Nation's second largest employer and the 11th largest by revenue—and it supports the $900 billion mailing industry.

While the Postal Service faces the challenges of demographic change and increased market competition, its rate-setting process and governance structure have been in place since the 1970's and are too cumbersome to meet today's needs. The two aspects of reform we are considering today will play important roles in the ability of the Postal Service to adapt to the changing marketplace.

Strong financial management and good governance have long been interests of mine. I believe that good business practices, strong financial accounting, and independent oversight are important to the overall success of any institution, and these are key areas to address in the transformational process at the U.S. Postal Service.

I look forward to discussing with our witnesses their views on improving the financial transparency of the Postal Service's operations so that it may better allocate its costs for rate-setting purposes. I also look forward to hearing the views of our witnesses regarding how to ensure that independent oversight of the Postal Service is both effective and efficient.

Again, I would like to commend Chairman Collins for her sustained and strong leadership on this important issue. I look forward to today's testimony.

Thank you, Chairman Collins.

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

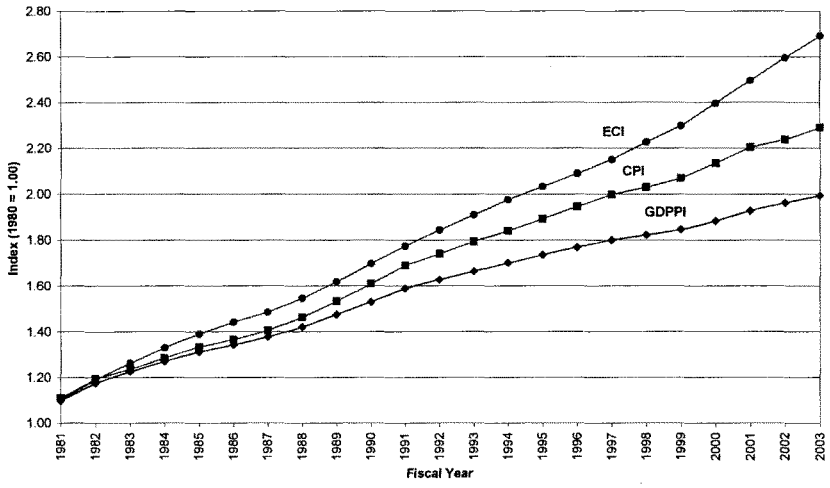
regulations, either by the Commission *sua sponte*, at the request of the Postal Service, or upon complaint by an interested person, ensures that over time the regulations will remain faithful to the legislative objectives despite changing market conditions, incorporating enhancements in costing methodology 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.

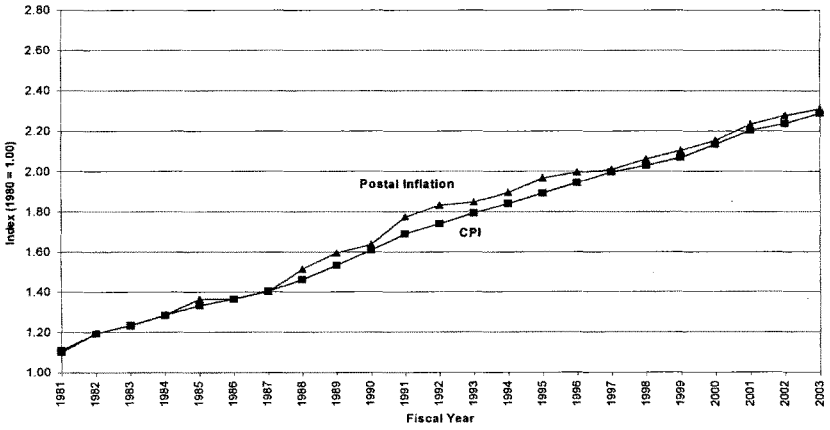
The Postal Service's Total Factor Productivity (TFP) report presents an index of postal inflation. It consists of the total costs of the Postal Service divided by its workload. Over the last two decades, postal inflation has almost exactly tracked increases in the Consumer Price Index (CPI).

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.

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[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

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[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.

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[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.

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[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.

STATEMENT OF S. DAVID FINEMAN, CHAIRMAN
UNITED STATES POSTAL SERVICE BOARD OF GOVERNORS
BEFORE THE
UNITED STATES SENATE
COMMITTEE ON GOVERNMENTAL AFFAIRS
APRIL 7, 2004

Good afternoon, Chairman Collins and Members of the Committee.

Thank you for the opportunity to talk with you about the critical issue of comprehensive legislative reform for the United States Postal Service. In particular, I look forward to discussing the vital role of appropriate governance of this indispensable engine of American commerce and communication. As always, I appreciate the interest of this committee in assuring the continuance of affordable universal mail service for each and every American.

Let me point out at the beginning that the views I am going to share with you today are the result of my years of experience as a member of the Board of Governors. The Board of Governors is a very diverse group, and not every member would necessarily agree with every position I mention today. But I have tried to capture the essence of the Board's position in most cases.

Since 1970, the Postal Service Board of Governors has directed the exercise of the power of the Postal Service. It establishes strategic policies, basic objectives, and long-range goals for the Postal Service. We take these responsibilities very seriously.

I have had the pleasure of being a member of the Board of Governors of the United States Postal Service since 1995. Over the course of those nine years, I have worked closely with my fellow governors to conscientiously carry out our legal mandate to "direct and control the expenditures and review the practices and policies of the Postal Service". I also came to realize early on that the law under which we operate is both antiquated and inefficient. I have had the pleasure of getting to know many of you and your staff as I have worked with you towards bringing about change to this law.

I have also come to appreciate more than ever the value of mail service to the American people and the role it plays in making the United States economy the greatest in the world. I am proud of the thousands of dedicated Postal employees who manage to get the mail delivered regardless of the obstacles faced.

There can be no doubt that we have faced some significant challenges in the last few years. I want to thank every member of this Committee, the General Accounting Office, and the Administration for their assistance in helping us address them.

Despite those challenges, the United States Postal Service has continued to deliver for our nation. In fact, in 2003, we set records in service, productivity and customer and employee satisfaction, while also maintaining universal mail service and generating a positive bottom line for the business. We closed the year with a net income of $3.9 billion, reflecting both our success in managing costs and improving efficiency and the positive effects of the Civil Service Retirement System funding reform legislation.

But these successes are masking a basic flaw in the business model upon which the Postal Service was founded. The assumption that growth in mail volume will provide sufficient revenues to meet the cost of providing universal service to an ever-growing number of delivery points is no longer valid. Since 2001, as First-Class Mail volume has been decreasing, our delivery network has expanded by 5.5 million new delivery points. We do not see this trend reversing.

Given the limitations of our current business model, this trend offers a daunting prospect for the viability of our current outdated legislative charter.

Nonetheless, the Board of Governors has the legal obligation to manage within the constraints of the current business model, so that is what we have been doing – and in my opinion, doing quite well. We are managing for results. We have asked management to focus on three key strategies: improving operational efficiency, adding value for our customers, and enhancing our performance-based culture.

With the help of management, Congress, and stakeholders, we identified each of these strategies in the Transformation Plan we developed in 2002. We know the Postal Service must continue to change to meet the needs of a changing nation. The Transformation Plan is helping us do that.

The Board of Governors has taken steps to take full advantage of all the flexibility granted to us by current law. Let me give you some examples, starting with the Board's fiduciary responsibilities. In February 2001, when the Chairman of the Board's Audit and Finance Committee reported that the trends in Postal Service finances were "alarming and unacceptable...", we quickly moved to re-examine how this organization was conducting business on all levels.

Management was directed to temporarily freeze all new facility commitments, reduce planned new facility commitments for the year by $1 billion, and limit future capital commitments to levels that could be funded from cash flow.

In the last three years capital commitments have been limited to those projects that have an acceptable return on investment, are required by law, or have been necessary to insure customer and employee safety. New commitments, which had averaged $3.5 billion per year in the five years leading up the temporary freeze, have averaged $1.6 billion per year in the three years since.

These measures have worked. Cash flow has been adequate to fund capital spending in the last three years and debt has fallen.

Perhaps the most important way in which the Governors provides direction to the Postal Service is through the selection of the Postmaster General. In selecting Jack Potter, a career operations veteran to lead the organization, the Governors sent a clear signal that service, performance, cost control, and productivity improvement were the priorities.

The organization responded. Service performance scores climbed to record levels and the number of our career employees declined by 24,000 in 2003. Our Fiscal Year 2004 operating plan calls for a reduction of 25 million work hours. We are on track to achieve that – in fact, through February we have already experienced a reduction of over 15 million work hours. During that same time frame, we have reduced our career complement by over 14,000 employees, and best of all, we have reduced these positions through attrition, voluntary retirements, vacancies and reassignments. No employees were laid off.

The Board's focus on the bottom line has strengthened financial management within the Postal Service. The spread between long-term and short-term interest rates last year created an opportunity to refinance our debt, reducing our average interest rate from 5.1 percent to 1.1 percent. As a result, we saved $62 million in interest in 2003. And, we expect to save an additional $336 million in 2004.

There is another area where the Board has asked management to take a long, hard look at current practices – the vast network of facilities and transportation infrastructure that has developed over the years. In my opinion, the opportunity to consolidate operations and streamline our network represents a significant cost reduction opportunity. A leaner plant network would drive transportation and facility costs down. That benefits everyone.

Along the same lines, I think the Postal Service must be allowed room to implement infrastructure changes including – but not limited to – changes in the number and location of post offices and processing plants, and changes in our transportation networks. That simply makes good business sense.

We are also enhancing existing products and services – and expanding access and convenience to postal services.

By providing focused leadership and support to an able top management, the Board of Governors has helped the organization effectively address a number of difficult problems. We are fortunate to have the management team we do as we face the challenges ahead of us.

But let us be clear about those challenges. The combination of declining First-Class Mail volume, increasing delivery points, and expanding fixed costs over which we have no control – such as statutorily-mandated employee benefit costs – has put the Postal Service into a box. And that is a box which no amount of good management, cost cutting, or improved efficiency can get us out of. We cannot, and we will not, get out of the box – because the current business model will not allow us to.

Each year, as we aggressively pursue additional improvements, the margin of return becomes smaller as efficiency increases. Essentially, the more we improve our efficiency, the less room there is to make up for the gap caused by the fixed costs inherent in our current business model. We must have legislative change.

In March 2001, the Governors sent a letter to Congress and the President specifically stating the need for significant statutory reform in pricing and labor flexibility. The letter stated: "We see alarming trends that seriously threaten the future of America s mail service... Without change to our regulatory framework, universal service will be difficult to maintain. We foresee rapidly rising rates and reduced service if legislative reform is not enacted promptly..."

That is why we were so pleased by the creation of the President's Commission on the United States Postal Service. During the eight months that the nine-member bipartisan commission held public meetings and met with stakeholders, we provided the Commission with a great deal of information and documentation about our organization's needs and concerns. The Postmaster General and I testified before the Commission. Other Postal Service leaders testified in detail about their areas of expertise as well.

The Commission, in its final report, offered recommendations for change in several key areas: the Postal Service business model, private-sector partnerships, technology and workforce. The President publicly urged Congress to enact postal reform legislation based on five principles that were in the Commission's report. We agree with the goals of these five principles – Best Practices, Transparency, Flexibility, Accountability, and Self-Financing. In many ways, they mirror our Transformation Plan for the Postal Service. The President's Commission also said the Postal Service should set the standard for financial transparency by which all other Federal entities are judged. I agree.

In fact, last August, at the Board's direction, the Postal Service began to enhance the transparency of its financial reporting. Our 2003 Annual Report includes enhanced disclosure in the footnotes and the Management Discussion and Analysis section. And, earlier this year, the Board of Governors met with senior Postal Service officers to discuss the topic of more transparent annual disclosures. We continue to work on ways to further enhance our annual financial reporting as well.

But, let me turn to the crux of the matter. When the Commission issued its final report, it stated that: "the Commission envisions a strong, independent, and experienced Board of Directors that reflects the size, scope, and significance of the Postal Service's work..." I agree with that assessment. However, the Commission recommended significant changes to our governing board. I cannot agree with all of their recommendations, and I want to tell you why.

Today, the Governors are appointed by the President with the advice and consent of the Senate. They serve staggered nine year terms, and by law, no more than five members may belong to same political party. This structure has allowed the Postal Service to enjoy bipartisan oversight and consistent governance of this $68 billion national service provider. I am concerned that the Commission's proposal for a new Board of Directors could change this.

Under the Commission's recommendations, the President would appoint three Board members, who would then select the first eight independent Board members, with the concurrence of the Secretary of the Treasury. After that, independent members would be selected by the Board as a whole, again with the concurrence of Secretary of the Treasury. But there would be no limits on the political affiliation of Board members.

In addition, the proposal allows the President or the Secretary of the Treasury great latitude to remove what the Commission calls "independent" Board members.

My concern is that, if enacted as proposed, the Senate's statutory role of "advice and consent" would be greatly diminished. The lack of party affiliation requirements and the ability of the President and Secretary of the Treasury to remove members of the Board could potentially result in highly-partisan Boards in the future. Under this arrangement, the Commission would actually reduce the independence of individual Board members, who could be perceived as fearing replacement for voting against the interests of the current Administration in power.

Rather than becoming more impartial and businesslike, a Board of Directors as envisioned by the Commission could be less impartial, less knowledgeable, and possibly more political. This could affect public opinion of the impartiality of the Board as well. Certainly, I do not believe this would make the Board more independent.

The Commission has recommended a mandatory retirement age for the Board as well. Certainly, I believe an age requirement of some sort may be appropriate, but 70 seems to be on the low end of what an experienced Board may require.

As for the recommendation that members serve three year terms, I think that too seems to fall on the low end of practicality. A five year term might make more sense, and it would allow Board members to be perceived as less partisan by serving across Presidential terms of office.

And, I have a final point on Board membership. I agree with the Commission that qualifications are appropriate for members of the Board of Directors, as they are for members of the proposed Postal Regulatory Board.

I would also like to share some concerns I have with the Commission's recommendations concerning another aspect of governance – the proposed Postal Regulatory Board. I fully understand that with an increased level of management flexibility must come an appropriate level of oversight. This provides the necessary balance to protect the public interest.

The Commission proposes that this oversight be largely provided by a new Postal Regulatory Board, with discretionary policy authority in a wide range of areas, to replace the current Postal Rate Commission, which has a more limited mandate.

I understand the rationale for the discretion the President's Commission has defined for the Postal Regulatory Board. Yet regulators are normally required to operate within limits and guidelines. Regulated private companies and their shareholders have legal protections against arbitrary action by the regulator that the Postal Service cannot have as a government institution.

At the least, there should be standards drawing a clear line between what is appropriately a managerial function within the oversight of the Governors or Directors, what is a regulatory function committed to the regulator, and what is a public policy function reserved to the nation's lawmakers.

For instance, the Postal Regulatory Board can revisit the vital national issues of the postal monopoly and universal service. From the perspective of the Postal Service Board of Governors, I think these are clearly issues of broad public policy that should be resolved as part of our management responsibilities, as determined by Congress.

They are not regulatory issues. Without defined limits or guidelines, the regulator could conceivably limit the monopoly in such a way as to jeopardize universal service or even redefine the scope of the nation's mail service itself.

Similarly, the Commission's recommendations would remove the determination of how much money is needed to run the nation's postal system from the operators – those with the day-to-day responsibility of running the postal system – and transfer it to the Postal Regulatory Board. This would occur through the new rate-setting mechanisms recommended by the Commission. At the very least, I believe those provisions should recognize that the Postal Service is a labor-intensive industry which operates as part of our economy's service sector.

The powers of the proposed Postal Regulatory Board could also affect the outcome of the collective-bargaining process. The Postal Service has been, and continues to be, a strong supporter of collective bargaining. This process of give and take assures that the interests of our employees – and the unions that represent them – are considered within the larger picture of the Postal Service's financial situation and the needs of our customers.

Since the advent of collective bargaining in the Postal Service in 1971, there have been voices from all sides on whether postal wages were or were not comparable with private-sector wages, as required by current law. The Postal Regulatory Board would be charged with making a "comparability" determination that would presumably end that argument.

But the issue of comparability is dynamic and depends on economic factors and job skill requirements that can change with time and circumstances. A wage comparability determination made by an independent Postal Regulatory Board may be useful during periodic contract negotiations, but I firmly believe it is important to permit the Postal Service and its unions to engage in direct negotiations which balance the needs of all parties without requiring strict adherence to the results of any specific comparability determination.

By determining the range within which wages may be negotiated, I think the Postal Regulatory Board could impede the ability of the parties to successfully negotiate agreements.

In conclusion, as I have mentioned, under the current Board, the United States Postal Service has delivered some incredible successes, despite growing competition, new electronic forms of communication, and a difficult economy.

In spite of continuing challenges, I know the Board of Governors will continue to do everything possible to protect the basic right of affordable, universal mail service for everyone in America. We will take all positive actions available to us within the current law to make the Postal Service more efficient and customer responsive.

Yet we must face the simple fact that our business model — established by the 1970 Postal Reorganization Act — is no longer valid. We can no longer expect that the costs of serving a continually expanding delivery base will be offset by increasing revenue from continued mail volume growth.

We cannot be asked to conduct ourselves in a businesslike manner when the tools to do so are not available to those running the business. The Governors of the Postal Service need additional flexibility in directing the activities of the Postal Service. The Postal Service's ability to adjust its retail network is constrained by current law. We have a burdensome rates process. We are being asked to operate in a very competitive marketplace without the ability to negotiate prices and service with our major customers. We need legislative reform of the way we do business, not of the way we manage that business.

This is my last year of service on the Board, so I have some perspective on the process. I intend to continue working with the entire mailing community on these critical issues. And I know the Board of Governors will continue to direct the organization with the full range of tools available to us under current law.

The Board of Governors will continue to do everything in our power to assure that the Postal Service of the 21st century will continue providing affordable, universal mail service for all customers and all communities in America. But we are reaching the limits of the current opportunities available to us without a change in the laws.

Thank you, Chairman Collins and Members of the Committee.

# # # #

Memorandum December 18, 2003

TO: Senate Governmental Affairs Committee
Subcommittee on Financial Management, the Budget, and International Security
Attention: Nanci Langley, Coordinator

FROM: Kevin R. Kosar
Analyst in American National Government
Government and Finance Division

SUBJECT: Governance of the U.S. Postal Service

This memorandum responds to your request for an analysis of the recommendations of the President's Commission on the United States Postal Service (PCUSPS) regarding Postal Service governance and oversight.[1] Your inquiries were:

1. Are there any precedents in the current governance structure of governmental agencies for the Commission's recommendation of a self-perpetuating Board of Directors with fiduciary and operational responsibility and a separate regulatory commission with authority to decide public policy questions, and the definition of universal service?

2. What are the implications for congressional oversight and governance?

3. What are the advantages and risks from such a governance structure?

In summation, much of what the PCUSPS has proposed is designed to enable the U.S. Postal Service to escape its long-term financial troubles. However, many of these suggested changes would come at the cost of reduced congressional oversight. Furthermore, the public and mailers may also find it more difficult to participate in decisions affecting USPS products and services were the PCUSPS recommendations to be enacted.

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[1] President's Commission on the United States Postal Service, *Embracing the Future: Making the Tough Choices to Preserve Universal Mail Service: Report of the President's Commission on the United States Postal Service* (Washington: Government Printing Office, 2003). Hereinafter referred to as *Report*.

Proposed U.S. Postal Service Governance

The U.S. Postal Service (USPS) is an unusual federal entity, arguably unique in its governance characteristics. It was a federal department for much of its history and was transformed into a government corporation in 1970.[2] The *United States Code* describes it as "an independent establishment of the executive branch," a term of indeterminate meaning.[3]

For the purposes of this analysis, USPS will be considered a government corporation. The Government Corporation Control Act does not include the USPS in its list of government corporations.[4] Nevertheless USPS is widely considered a government corporation.[5] Like the government corporations listed in the Government Corporation Control Act, USPS was established by Congress to perform a public purpose, is governmentally owned, and conducts commercial activities that aim to meet or approximate its expenditures.[6]

Most federal government corporations have managerial boards.[7] As a government corporation, the USPS is peculiar because it is governed by both a managerial board (the Board of Governors) and a regulatory board (the Postal Rate Commission).[8]

The PCUSPS proposes retaining this dual structure of governance but with considerable modifications. The PCUSPS proposes replacing the "distinctly public-sector leadership" of the present Board of Governors (BG) with a corporate-style Board of Directors (BD) that would have broad authority to oversee postal operations.[9] The board would consist of three

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[2] 39 U.S.C. 2. On classifying government entities, see CRS Report RL30533, *The Quasi Government: Hybrid Organizations with Both Government and Private Sector Legal Characteristics*, by Ronald C. Moe.

[3] 39 U.S.C. 201.

[4] 31 U.S.C. 91.

[5] See CRS Report RL30365, *Federal Government Corporations: An Overview*, by Ronald C. Moe, and U.S. General Accounting Office, *Government Corporations: Profiles of Existing Government Corporations*, GAO Report GGD-96-14, Dec. 13, 1994.

[6] Some government corporations, such as the Saint Lawrence Seaway Development Corporation, are funded through appropriations; others are not. USPS, by charter, aims to generate revenues sufficient to cover its expenditures. Appropriations make up a very small portion of its budget. See CRS Report RS21025, *The Postal Revenue Forgone Appropriation: Overview and Current Issues*, by Nye Stevens.

[7] CRS Report RL30365, *Federal Government Corporations: An Overview*, by Ronald C. Moe, p. 11.

[8] USPS is, of course, also governed by statute and Congress. In terms of corporations with similar governance structures, the Communications Satellite System (Comsat) may come to mind. Comsat was created by federal statute (P.L. 87-624) in 1962 and had both a board of directors and was regulated by the Federal Communications Commission. Comsat, however, was a private, not governmental, corporation. Comsat was fully privatized by P.L. 106-180 in March, 2000 and was merged into Lockheed Martin Corporation in August of that year.

[9] *Report*, pp. 38-46. The PCUSPS does not elucidate the essential natures of private and public sector leadership. One fairly common way of differentiating public and private sector management

(continued...)

directors whom the President would appoint. These three appointees would then appoint seven "independent" directors, with the concurrence of the Secretary of the Treasury.[10] Members of this board would be selected on the basis of their "significant financial and business expertise," and would serve three-year terms.

PCUSPS further advises replacing the present Postal Rate Commission (PRC) with a three-member Postal Regulatory Board (PRB), the members of which would be appointed by the President with the advice and consent of the Senate. In general, the PRB would be responsible for "public policy oversight" of the USPS, although its powers over rate-setting and defining employee compensation would also give it considerable influence over operations.[11]

PSUSPS's proposal is novel on two counts: the manner of appointment of the Board of Directors and the powers of the Postal Regulatory Commission.[12] PCUSPS has proposed that the Board of Directors be largely self-appointed. As conceived by the PCUSPS, the President would appoint the first three members of the BD; these three would then appoint another eight members. These nine directors, then, would appoint the postmaster general, who would also sit on the BD. Usually, members of the board of a government corporation:

1) are appointed by the President with the advice and consent of the Senate;

2) are appointed by a department secretary (e.g., the board of the Federal Crop Insurance Corporation is appointed by the Secretary of Agriculture);

3) serve *ex officio*, i.e., by virtue of their position in government (e.g., the Federal Deposit Insurance Corporation consists of the Comptroller of the Currency, the Director of the Office of Thrift Supervision, and three presidential appointees); or

4) are elected by shareholders (in the case of a mixed ownership corporation).

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[9] (...continued)
is to argue that public sector management focuses first and foremost on compliance with public laws and regulations while private sector management focuses on results. Some who accept this conceptualization then argue that the public and private spheres are distinct and that to confuse them (e.g., by running a government agency in a private sector manner) will lead to a betrayal of the public trust. In light of the recent corporate scandals where corporate boards failed to protect investors from managerial misdeeds, this point of view has gained acceptance.

[10] These nine directors, then, would appoint a postmaster general. The postmaster general chooses a deputy postmaster general and they sit as the tenth and eleventh members of the BG.

[11] *Report*, pp. 53-58. By their very nature, the compensation of postal (i.e., federal) employees and the mailing rates paid by the public are matters of import to the public and affect the Postal Service's bottom line. As long as the USPS remains a government corporation, an absolute separation of operational and policy responsibilities between governance entities is impossible.

[12] Something similar for USPS was proposed once before. In the late 1960s, the presidentially appointed Kappel commission proposed a nine-member Postal Policy Board; six members would have been appointed by the President with the advice and consent of the Senate, and then these six would have chosen a CEO (who would serve as director of and chair of board), COO, and second corporate officer. The President's Commission on Postal Organization, *Towards Postal Excellence* (Washington: GPO, 1968).

Indeed, PCUSPS's suggested method of appointing members to the Board of Directors (who would then appoint their successors) may violate the Appointments Clause of the Constitution.[13]

The second unusual feature of the PCUSPS proposal is its placement of considerable public policy, fiduciary, and operational responsibilities in one set of hands: the Postal Regulatory Board. For example, the PRB would set caps on both stamp prices and employee compensation. The Postmaster General contends that powers like these are managerial and operational by nature and, hence, should rest in the hands of USPS.[14] Postal labor representatives have also criticized the idea of having an outside entity involved in collective bargaining.[15]

The PCUSPS would also give the PRB the power to define the scope of the Postal Service monopoly and the meaning of "universal service." Some observers find this alarming. For example, *PostCom Bulletin: The Journal of Postal Commerce* opined:

> [N]o purpose would be served, and serious harm would ensue, if these profoundly public policy issues were simply transferred to an independent agency. It is a bedrock principle of the American system of administrative law that the task of independent agencies is to neither make nor define public policy.[16]

This issue of the power of the PRB is ambiguous in large measure due to the limited details provided by the PCUSPS. How potent did the PCUSPS intend the PRB to be? It is worth recalling that presently the Postal Service does, by issuing regulations to delineate mail classes, define the extent of its own monopoly.[17] The PCUSPS suggests moving this power from USPS to the PRB but does not make clear how much of this monopoly-defining power would go to the PRB and how much would be specified in statute. This is a critical matter.

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[13] This new, self-perpetuating Board of Directors would possess some of the same powers as the present Board of Governors (e.g., hiring and removing the postmaster general). This is pertinent because a federal appeals court ruled that the present Board of Governors, by virtue of its powers (including the appointment ability) and the nature of USPS, collectively constitutes a head of department. Under Article II, Section 2, Clause 2 of the Constitution, a head of department must be appointed by the President with the advice and consent of the Senate, and in turn, the head of department may appoint inferior officers. See *Silver v. U.S. Postal Service*, 951 F. 2d 1033 (9th Cir. 1991) at 1038.

[14] Statement of Postmaster General/CEO John E. Potter Before the Committee on Governmental Affairs, United States Senate, Nov. 5, 2003, pp. 14-15, available at [http://www.usps.com/communications/news/speeches/welcome.htm], visited November 11, 2003.

[15] Stephen Losey, "Unions, Lawmakers Criticize Commission's Report," *Federal Times*, July 28, 2003, p. 13.

[16] *PostCom Bulletin: The Journal of Postal Commerce*, vol. 47-03, Nov. 17, 2003, p. 8, available at [http://www.postcom.org/public/general/bulletin.htm], visited December 3, 2003. This comment may overstate matters. In the course of adjudicating on the meaning and extent of the laws, regulatory bodies, like courts, make and define public policy.

[17] Statement of David M. Walker, Comptroller General of the United States, Testimony Before the Committee on Governmental Affairs, United States Senate, *U.S. Postal Service: Bold Action Needed to Continue Progress on Postal Transformation*, GAO Testimony GAO-04-108T, Nov. 5, 2003, p. 13. As Geddes has noted, in 1974 USPS redefined the meaning of a letter to include a broader class of items, thereby expanding its monopoly. Rick Geddes, *Saving the Mail: How to Solve the Problems of the U.S. Postal Service* (Washington: American Enterprise Institute, 2003), pp. 14-15.

There is a great difference between charging PRB with interpreting and applying detailed statutes drawn up by Congress and empowering the PRB to define these matters with the present minimal statutory guidance.

Beyond this immediate question of power is the issue of power delegation. If the PRB was given little statutory guidance on decisions involving the Postal Service's monopoly and rate-setting, some suggest that the courts might find this an unconstitutional delegation of legislative powers.[18] Yet, it is the case that Congress has empowered regulatory commissions to set and adjudicate rates for products. For example, the Federal Energy Regulatory Commission may set "rates and charges collected by a public utility in transmitting or selling electric energy in interstate commerce," and may order utility companies to provide refunds for excessive rate charges.[19] The Surface Transportation Board, in its former incarnation as the Interstate Commerce Commission, set interstate railroad and truck shipping rates.

On the matter of pay and compensation, as noted previously, PCUSPS would have the new PRB "be responsible for determining that the Postal Service is in compliance with statutory provisions requiring comparable pay to the private sector."[20] By comparable pay, PCUSPS means "total compensation," not just wages and salaries.[21]

Generally speaking, the pay and compensation of nonpostal government employees and pay comparability with the private sector have been set by Congress and the President through statute.[22] The case of government corporations is a bit different, as one of the attractions of creating a corporation is exempting it from certain government rules, notably regarding compensation. Having a regulatory board determine comparable pay, then, would be something altogether new.[23]

Unions, sensing a threat to their compensation packages, have already objected to giving the PRB this power. However, it should be noted that, in terms of government involvement in determining government corporation employee pay, PCUSPS's proposal sails between the two current ways of doing business. Some government corporations compensate their employees according to Title 5, of the U.S. Code; others do not. These government

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[18] Institute for Research on the Economics of Taxation, "Presidential Postal Commission Recommends Cost-Control Reforms, Not Business Expansion," *IRET Congressional Advisory*, Oct. 16, 2003, p. 7. In fact, the power of Congress to delegate legislative and adjudicatory powers is quite broad. See Morton Rosenberg, "Congress's Prerogative Over Agencies and Agency Decisionmakers: The Rise and Demise of the Reagan Administration's Theory of the Unitary Executive," *George Washington Law Review*, vol. 57, no. 3, 1989, pp. 627-703.

[19] CRS Report RS20774, *Authority of the Federal Energy Regulatory Commission to Fix Electricity Rates and Charges and to Require Refund Payments by a Public Utility*, by Michael V. Seitzinger.

[20] *Report*, p. 69.

[21] *Report*, p. 117.

[22] The Bureau of Labor Statistics, Federal Salary Council (FSC), the President's Pay Agent, who, in turn, reports to the President. The President may then issue an executive order to increase pay, although he is not required to take the recommendations of the FSC.

[23] The Interstate Commerce Commission did adjudicate disputes between labor and management.

corporations are not subject to Title 5 and bargain with their employees directly.[24] For example, employees of the Tennessee Valley Authority, like USPS employees, are not on the federal general pay schedule. Congress exempted TVA's board from having to abide by "the provisions of the Civil Service laws" in the hiring and compensation of "managers, assistant managers, officers, employees, attorneys, and agents."[25] Thus, TVA has negotiated salaries and benefits on its own with its worker unions. In its dealings with nonemployee contract workers, TVA must pay "not less than the prevailing rates of wages for work of a similar nature [...] in the vicinity."[26] TVA negotiates pay comparability rates with its unions. If they are unable to reach an agreement, the Secretary of Labor makes a final determination.

On the question of power and control more generally, some critics of the Commission's proposal for a new governance structure for USPS contend that Congress should exert more control over USPS. The proposed Postal Regulatory Board and, to a lesser extent, the Board of Directors, they say, should not decide fundamental matters of public policy when they render decisions on rates, and define universal service and the postal monopoly.[27] These tasks, critics say, are the province of Congress alone. On the other hand, underlying the Commission's argument may be the conclusion that Congress is too immobilized by conflicting pressures from unions, USPS competitors, and mailers to make definitive reforms. Failure of Congress act on postal reform for many years of financial turmoil is some evidence for that view.[28]

Government Corporations: Governance Precedents

Whether one agrees or not, PCUSPS' proposed delegations of power to a governmental corporation are not unprecedented. In fact, Congress has delegated even more power to government corporations. The National Passenger Railroad Corporation (Amtrak) is one example; the Tennessee Valley Authority is another. Amtrak is a government corporation that possesses a limited monopoly (over nationwide passenger rail travel).[29] The seven-member board of Amtrak may set its rail fares as it chooses; it also is free to define the extent of its monopoly by deciding the extent of its routes. No PRC- or PRB-type regulatory board needs to approve these decisions.

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[24] A 1995 survey of government corporations revealed that only seven of the 22 government corporations surveyed reported being fully subject to the *U.S. Code*'s Title V pay rates and rate systems requirements. Another five corporations reported they were not subject to Title V at all. U.S. General Accounting Office, *Government Corporations: Profiles of Existing Government Corporations*, GAO/GGD-96-14 (Washington: GAO 1995), p. 35.

[25] 16 U.S.C. 831b. It is also worth recalling that TVA's statutory mission is quite broad. TVA has been allowed by Congress, for the better part of seventy years, to define its mission as it sees fit. Thus, TVA has produced electricity, manufactured fertilizer, fought malaria, managed land-use, and engaged in micro-lending to small businesses, among other efforts.

[26] 16 USC Chapter 12A, sec. 831b.

[27] For example, see Postal Rate Commission, "Comments of the Postal Rate Commission Concerning the Commission on the Postal Service," paper submitted to the United States Senate, Committee on Governmental Affairs, November 19, 2003, p. 5.

[28] CRS IB10104, *Postal Reform*, by Nye Stevens.

[29] Limited here means that Amtrak does not have a monopoly over all modes of personal transport (bus, plane, automobile), but over one of the types of means (passenger railway).

To take a second example, the Tennessee Valley Authority (TVA), in fact, has far more power in fewer hands. TVA is overseen by a three-person Board of Directors, the members of which are appointed with the advice and consent of the Senate for terms of nine years. The Board of Directors, as the law notes, "shall direct the exercise of all powers of the Corporation."[30] Only two of the three need to be (and often are) appointed; just two directors need to be present to constitute a quorum and exercise TVA's powers. The Board of Directors of TVA have full rate-setting authority for the electricity it sells. Thus, should TVA raise rates for residential and most nonresidential customers 7.4%, as it recently proposed to do, customers have no agency akin to the present Postal Rate Commission or the proposed Postal Regulatory Board to which they may appeal. Judicial review is also precluded.[31]

Implications for Oversight and Governance

The earliest thinking on government corporations emphasized corporate autonomy. Government corporations were to be run by expert, apolitical appointees; and "[g]ood administration would involve the apolitical application of technical competence to politically defined ends."[32] The great danger, according to this Progressive-era way of thinking, was micromanagement by politicians. Accordingly, managers of government corporations and similar entities were to be given maximum autonomy and minimal political oversight. This way of thinking about government corporations "cast the legislature [...] in the role of stockholder, viewing Congress, rather than the executive, as the ultimate source of accountability."[33] The executive of the corporation (whether it be one person or a board), was conceptualized as "the operating board [...] determining the minor matters of policy, regulation and control."[34]

Another school of thought on government corporations has emphasized minimal congressional oversight in favor of vigorous executive management. Government corporations, as tools for achieving politically decided ends, should be under the power of the executive, whom the *U.S. Constitution* charges with "tak[ing] care that the Laws be faithfully executed."[35] To this end, advocates for this way of thinking urge that government corporations be situated within departments of government and be directly accountable to presidential appointees.[36] This debate over control and oversight of the actions of

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[30] 16 USC Chapter 12A, sec. 831g.

[31] See Tennessee Valley Authority, Final Environmental Assessment: Rate Change Proposal (Knoxville: TVA, Aug. 2003) visited at [http://www.tva.gov/environment/reports/rates/] Oct. 24, 2003.

[32] Annmarie Hauck Walsh, *The Public's Business: The Politics and Practices of Government Corporations* (Cambridge, MA: The MIT Press, 1978), p. 38.

[33] Ibid., p. 39.

[34] Marshall Dimock, "Government Corporations: A Focus of Policy and Administration," *American Political Science Review*, vol. 43, Oct. 1949, p. 914.

[35] Article II, sec. 3.

[36] This was enunciated, perhaps most famously, in the 1937 Brownlow report, which urged independent boards, agencies and the like be placed within the executive branch and made directly

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government corporations and instrumentalities was carried out over much of the past century.[37]

The Postal Service, as presently constituted, does not quite fit into either of these major schools of thought. Advocates for the Postal Reorganization Act of 1970, which created the Postal Service governance structure of today, emphasized the corporate part of government corporation. Had the Kappel commission had its preference, the United States Post Office (USPO) would have been entirely privatized.[38] Interestingly, these reformers, like the Progressives, saw elected public officials as the problem. Political oversight made for political patronage and inept management.[39] Accordingly, the advocates for reform sought to remove politicians as much as possible from the management of USPO. The postal department would be abolished, appropriations would be minimized, and the new U.S. Postal Service would be required to behave like a business, earning enough to meet its expenses. In order to keep USPS from trampling on the public good and the interests of mailers, the Postal Rate Commission was created.[40]

The thinking of the President's Commission on the United States Postal Service, to a degree, reflects the Progressive school of thought. The PCUSPS view differs, though, from that of the Progressives who believed Congress should serve as the primary oversight agency. On the whole, PCUSPS proposes a model that would free USPS from more statutory constraints (thus making it better able to behave like a private corporation), but make it more accountable to the President (rather than the Congress).

The list below describes the probable implications for postal oversight of various PCUSPS recommendations based on factors believed to affect the behavior of government boards generally and factors particular to the Postal Service.[41]

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[36] (...continued)
answerable to the President. U.S. President's Committee on Administrative Management, *Report with Special Studies* (Washington: Government Printing Office, 1937).

[37] For an overview of the history and jurisprudence of executive versus congressional control of governmental entities, see Rosenberg, "Congress's Prerogative Over Agencies and Agency Decisionmakers,"pp. 627-703.

[38] U.S. President's Commission on Postal Organization, *Toward Postal Excellence*, p. 2.

[39] On patronage and USPS, see Robert R. Nathan Associates, Inc., "Personnel and Labor Relations" in President's Commission on Postal Organization, *Toward Postal Excellence*, p. 90-92. On legislative mismanagement, see President's Commission on Postal Organization, *Toward Postal Excellence*, pp. 29-64.

[40] Devins notes that "despite difference, the Nixon administration, House, and Senate all envisioned a single body principally responsible for postal ratemaking." Either the BG or the PRC (which would be located within the new postal service) would have complete power over ratemaking. However, some members of the Senate worried about unchecked power to set rates. They won their colleagues over to the view that the PRC should serve as an external check on the BG. Neal Devins, "Tempest in an Envelope: Reflections on the Bush White House's Failed Takeover of the U.S. Postal Service,"41 UCLA Law Review 1035 (1994), at 1051-1053.

[41] On board structures and behavior, see Jerry Mitchell, "Representation in Government Boards and Commissions," *Public Administration Review*, March/April 1997, vol. 57, no. 2, pp. 160-167.

Method of appointment of BD. Increases independence of operations management from Congress and the President by creating a self-appointing board.

Method of appointment of PRB. No change; members of PRB, like PRC, would be appointed by the President with the advice and consent of the Senate.

Tenure and Removal of BD members. PCUSPS would have the operations management of USPS shift from BG members serving nine-year terms to BD members serving three years. Reduced term-lengths likely will result in increased board responsiveness to the appointer, i.e. the President. PCUSPS also would allow the President to remove presidential appointees and permit the Secretary of the Treasury to remove BD-appointed directors for any reason. By statute, BG members can only be removed for cause. Thus, this proposed alteration would clearly further increase the influence of the President over postal operations board members.[42]

Tenure and Removal of PRB members. The decrease in tenure of regulatory board members from six to five years may increase responsiveness of regulatory board to the President. PCUSPS did not specify under what conditions a PRB member may be removed. Now, a PRC member can be only removed for cause.

Size of BD membership: Replaces the 11-person BG with the 12-person BD. This seems unlikely to have appreciable effects.

Size of PRB membership. Reduces the five-member PRC to the three-person PRB and requires that only two PRB members be present to constitute a quorum). The reduction of the number of members may increase the regulatory board's independence from Congress as fewer individuals may translate into fewer congressional interests represented.

Nature of BD membership. PCUSPS would make operations management of USPS slightly more corporate by requiring appointees to have extensive business and managerial experience. This might, perhaps, result in directors who are less responsive to congressional concerns on some issues (e.g., labor concerns). Two caveats must be noted. First, that the type of individuals who qualify to serve on the BD would depend entirely on the qualifications as enumerated in statute and enforced by the Senate when it offers its "advice and consent". Second, the present BG consists mostly of individuals with experience in business (although perhaps half can be said to have extensive private sector managerial or executive experience).

Nature of PRB membership. PCUSPS suggests members of the PRB "have backgrounds in areas relevant to the regulation of large, complex, business entities."[43] PRC members, by contrast, have tended to come from more diverse backgrounds.[44] This might increase USPS

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[42] When President George H.W. Bush attempted to remove a member of the Board of Governors for what appeared to be policy reasons alone, he was enjoined from doing so. *Mackie v. Bush*, 809 F. Supp. 144 (D.D.C. 1993).

[43] *Report*, p. 55. This is peculiar insofar as PRB members are to serve as regulators who are to act in the public interest (as opposed to the business interest of USPS).

[44] For example, among the four present PRC members (there is one vacancy), one has served as the director of a state political party, another has been a public advocate on an assortment of issues, one

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regulatory independence from Congress by giving the PRB a more technocratic (and less public interest and political) outlook.

Powers of PRB and BD over rate-setting. PCUSPS proposals would make USPS more private and commercial and less public and governmental. This may occur through removing regulators from small rate changes, by reducing the periods for public lobbying in large rate change decisions, and by instituting after-the-fact reviews for small rate increases.

Statutes and USPS control over costs. PCUSPS would increase USPS independence from Congress through the repeal of some statutory mandates, especially those affecting USPS operational costs. PCUSPS proposes repealing statutory limitations on closing postal facilities and creating a military-base closings type commission (the determinations of which could not be amended by Congress) that would shutter excess postal facilities.

The Advantages and Disadvantages of PCUSPS' Proposed Governance

A number of advantages and disadvantages have already been mentioned in the discussion above. Several more are worthy of mention, along with some general observations on the changes PCUSPS contemplates.

- Governance of USPS operations may be made more efficient by the insertion of a requirement that members of the BD be selected based on business experience and acumen. Of course, one might argue that since the USPS is a government entity, private sector managerial experience does not necessarily translate into public sector managerial excellence. The Postal Service is subject to a range of federal laws, managerial and otherwise.

- The self-appointing Board of Directors is problematic. Beyond the aforementioned constitutional questions about it, the ideas advanced to justify this new operations board appear to be contradictory. On the one hand, the board is intended to be free from political influence; it is envisioned as a corporate-type board whose members are chosen for their business acumen. Yet, the President and his Secretary of the Treasury are able to remove members for any reason whatsoever. Moreover, there are no limits to the number of directors who may come from the same political party. This raises the possibility of a politicized board speaking in one voice with the President.

- The power and independence of the proposed Postal Regulatory Board has raised considerable concern. While not stated explicitly, it would appear that the PCUSPS intended to create a board that is empowered to make decisions of considerable consequence (e.g., closing postal facilities and employee pay comparability) and sufficiently insulated from political influence to actually do so. This might be viewed as an extension of the thinking behind the reforms of 1970. Though the

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[44] (...continued)
was employed by the Office of the Sergeant at Arms of the U.S. Senate, and another worked for the Committee on Post Office and Civil Service of the U.S. House Representatives.

analogy is imperfect, the PRB might be likened to the Board of Governors of the Federal Reserve System. Widely regarded as above politics, the Board of Governors is entrusted to examine the condition of the U.S. economy and make major public policy decisions (i.e., adjust the money supply) with major economic implications.[45]

- Under the current arrangement, the postmaster general serves as the chief executive officer of USPS. Despite this, statutory and governance constraints curb his power to rein in costs by closing postal facilities and raising prices for the products his company produces. PCUSPS hopes to change this through P-NOC and the new rate change governance structure.

- Under the Commission's proposal, the BD of USPS would be able to raise or lower rates within the bounds set by the PRB. This would, clearly, improve the Postal Service's ability to respond to shifting market conditions, thereby helping it better meet its mandate to generate sufficient revenues to cover costs. However, there are costs involved. The Postal Rate Commission has recently noted that the

> "Administrative Procedure Act [...] codifies many important safeguards the American public has come to associate with its government such as an opportunity to be heard; fair and open hearings; and reasoned, record-based decisions. It is the basis for our operating regulations at the PRC, most notably for rate and classification proceedings."[46]

  Mailers would only be able to contest rate changes within these bounds after the fact.[47] More generally, the PCUSPS proposals to expedite the rate-changing process (e.g., limiting major rate change cases to 60 days and allowing only written testimony; giving USPS management the freedom to charge what it pleases for competitive products) decrease direct stakeholder involvement for improved efficiency. Depending on one's point of view, this may be either good business sense or it might well impinge on tenets of procedural justice and citizen participation in public matters.

- The PCUSPS has not proposed changing the Postal Service's duo-governance structure. As is presently the case, USPS would be overseen by two boards (and, of course, Congress).[48] Having two

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[45] For an introduction to the Federal Reserve System, see CRS Report RS20826, *Structure and Functions of the Federal Reserve System*, by Pauline Smale.

[46] Postal Rate Commission, "Comments of the Postal Rate Commission Concerning the Commission on the Postal Service," p. 3.

[47] PCUSPS would also permit only after the fact challenges on USPS granted worksharing discounts.

[48] One question not addressed by PCUSPS is whether USPS should have a managerial board at all. In private corporations, board members have a fiduciary responsibility to, and serve as the representatives of shareholders. For USPS, it is unclear whether BG or BD members are to represent mailers, the public generally, or the President who appoints them. Not surprisingly, a survey of

(continued...)

boards has its advantages. Two boards makes for two deliberative bodies, and presently each deliberative body is of a different nature. The Board of Governors is a part-time board that oversees postal operations. The Postal Rate Commission is more of a public policy and regulatory board. It is a venue for assorted stakeholders (the public, bulk-mailers, etc.) to seek redress for grievances.

The downside of oversight by two boards is clear: multiple boards that share discretion areas increase conflict and slow down the ability of USPS to make changes.[49] As has been widely reported, it can take up to 18 months for USPS to alter postal rates.[50] The postmaster general, though nominally in charge of USPS, has to work through two boards in order to enact major changes. Accountability for results is made complex by the limited control the postmaster general has over revenue and cost factors, and the multiple layers of governance. He is accountable to the Board of Governors, which, in turn, is collectively responsible to Congress (or the President, if the proposals of PCUSPS were enacted). The governance structure proposed by the PCUSPS would not change this duo-governance structure.[51]

- Currently, USPS governance is divided roughly between operations and public policy (though there are serious overlaps). Structurally, then the main difference is that PCUSPS proposes sharpening this division between an operations board and a public policy and adjudicatory board. The PRC would, generally speaking, set the bounds of possible operational activities of USPS such that the public interest would be served. This would clarify the responsibilities of the boards, thereby increasing efficiency and better enabling overseers to attribute responsibilities for results.

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[48] (...continued)
Board of Governors members revealed considerable confusion among them as to the mission and responsibilities of the Board. U.S. General Accounting Office, *U.S. Postal Service: Issues Related to Governance of the Postal Service*, GAO/GGD-97-141, Aug. 1997.

[49] Arthur D. Little, Inc., the general contractor for the Kappel commission, noted that creating a separate regulatory board with power over rate changes "would appear to duplicate the main function of the Postal Policy Board because whoever has primary control over rates must assume a major management function of balancing employee demands, user interests, and market opportunities, the public interest, and the economic health of the Corporation." Nevertheless, Congress added an external rate board. The President's Commission on Postal Organization, *Towards Postal Excellence*, quote at page 197 of "Report of the General Contractor."

[50] On the complex legal disputes that the present rate-setting governance structure permits, see Devins, "Tempest in an Envelope: Reflections on the Bush White House's Failed Takeover of the U.S. Postal Service."

[51] One way to sharpen the lines of accountability would be to remove the board that manages Postal Service operations and have the postmaster general report directly to Congress and/or the Secretary of the Treasury. Other governmental agencies, such as the St. Lawrence Seaway Development Corporation (SLSDC), have utilized this simpler managerial structure. SLSDC does have a board, but it has no formal powers and exists only to advise the administrator.

- Generally speaking, the PCUSPS proposals would decrease divided control over basic postal matters. The following table summarizes the basic differences in control.

Powers	Who exercises power	
	Currently	Proposed
Definition of monopoly	USPS/PRC	PRB
Definition of universal service	USPS/PRC	PRB
Determination of mailbox access	USPS/PRC	PRB
Determination of wages/compensation	USPS/Bargaining[52]	USPS limited by PRB
Setting of postal rates	USPS/PRC	USPS bounded by PRB

There are two main advantages to this simpler structure. First, this governance structure is designed to improve the ease and speed of decisionmaking. Second, as mentioned earlier, the Postal Regulatory Board is designed to be sufficiently independent that it can make politically difficult decisions.[53] Alternatively, a disadvantage of this governance structure is reduced participation in decisionmaking, especially by USPS management, a point noted by present Postmaster General John E. Potter.[54]

Conclusion

Much of the debate over PCUSPS's proposed postal reforms may be boiled down to the age-old conflict between democracy (defined as citizen participation and control) and efficiency. More venues for public participation increases the number of participants, making an institution more democratic and less efficient; fewer venues for stakeholders to make claims increases institutional efficiency, but decreases the democratic character of an institution. Questions about how best to structure and operate USPS are inevitable due to the hybrid nature of USPS. It is a private entity engaged in commercial transactions which are to result is sufficient revenue to cover expenditures; yet, USPS, in the name of serving the public good, is constrained from defining its market, limited in the products and services that it may sell, and curbed from controlling many of its operational costs. In short, the Postal

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[52] The Commission proposes a number of changes to the present compensation collective bargaining process. One alteration is that the Postal Rate Board would determine employee compensation comparability and this determination would serve as a "ceiling in collective bargaining." *Report*, pp. 112-123, quote at p. 118.

[53] In a sense, the PRC appears to be modeled on an entity like the Federal Reserve Board. It is to be above, and insulated from, politics, and free to make decisions which may be unpopular.

[54] Statement of Postmaster General/CEO John E. Potter Before the Committee on Governmental Affairs, pp. 11, 15-16.

Service is to not only run successfully as a business, but also to serve a public purpose and operate according to democratic norms of procedural justice and fairness.

The President's Commission has offered proposals for reforming USPS. This reform has been prompted by the recognition that the Postal Service's business model is flawed and that major changes will be necessary to keep USPS from running greater and greater deficits. The proposals of the PCUSPS are designed to meet this challenge by reworking Postal Service governance to increase the probability that politically difficult cost-cutting and revenue-increasing measures will be made. In short, PCUSPS has proposed inching USPS more in the direction of efficiency. This means taking a struggling government corporation and making it more private and commercial and less governmental.[55] The challenge for Congress is to enact reforms sufficient to preserve the U.S. Postal Service while protecting the interests of mailers and the public generally.

I trust this information is helpful to you and answers your questions. If you would like any further assistance on postal governance issues, please call me at x7-3968.

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[55] Speaking of movement along scales, PCUSPS would also further move USPS from its former pure government department status toward a private sector corporation.

Memorandum February 19, 2004

TO: Senate Governmental Affairs Committee
Subcommittee on Financial Management, the Budget, and International Security
Attention: Nanci Langley, Coordinator

FROM: Morton Rosenberg
Specialist in American Public Law
American Law Division

Kevin R. Kosar
Analyst in American National Government
Government and Finance Division

SUBJECT: Proposed Governance of the U.S. Postal Service

This memorandum responds to your request for further analysis of the recommendations of the President's Commission on the United States Postal Service (PCUSPS) regarding Postal Service governance.[1] In particular you wanted more information on the possible constitutional issues surrounding the proposed Board of Directors.

In brief, PCUSPS's proposed Board of Directors of the U.S. Postal Service (USPS) is, in itself, constitutionally unobjectionable. Its powers and nature are quite similar to the present USPS Board of Governors. However, the proposed method of selection of the members of the Board of Directors of the U.S. Postal Service would appear to raise serious legal questions under the Appointments Clause (Article II, Section 2, clause 2) of the U.S. Constitution. PCUSPS proposes to allow certain board members to select other board members. The Appointments Clause of the Constitution, however, requires principal officers to be appointed by the President with the advice and consent of the Senate. This memorandum will address the potential constitutional issues raised by PCUSPS's proposed scheme.

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[1] President's Commission on the United States Postal Service, *Embracing the Future: Making the Tough Choices to Preserve Universal Mail Service: Report of the President's Commission on the United States Postal Service* (Washington: GPO, 2003). Hereinafter referred to as *Report*.

Background

The Postal Reorganization Act of 1970 (PRA) replaced the U.S. Post Office with the U.S. Postal Service.[2] One of the ends to be effected by this reorganization was a Postal Service that ran more like a business. Thus, the law replaced the appropriations-dependent Cabinet-level department with a government corporation.[3] As a government corporation, the Postal Service was and is expected to cover its expenses through commercial transactions (i.e., mail delivery and postage collection).

Despite these reforms, three decades later the USPS still faces financial challenges.[4] While its short-term outlook has been improved by postage rate increases in 2001 and 2002, and by congressional passage of legislation relieving USPS of $9.2 billion in civil service retirement obligations in FY 2003-2005, USPS revenues are in a long-term decline.[5]

On December 11, 2002, President Bush signed Executive Order 13278, establishing the PCUSPS. The nine-member Commission was charged with examining the condition of the USPS and its financial viability and to recommend reforms. In its July 31, 2003 report, the PCUSPS suggested a number of significant reforms.[6]

Among these are a proposal to replace the present Board of Governors (BG) of the USPS with a Board of Directors (BD). The Board of Governors "directs the exercise of the power of the Postal Service."[7] The BG consists of 11 persons: nine governors (Governors) and two voting members (the Postmaster General and Deputy Postmaster General). The Governors appoint the Postmaster General (PG), who sits as the 10th member of the Board of Governors, and together they choose a Deputy Postmaster General (DPG), who sits as the 11th member. The Governors set the tenure and may remove either the PG or DPG at their pleasure. All 11 sit collectively as the BG. The Governors are appointed by the President with the advice and consent of the Senate. Not more than five of these nine may be of the same political party. The nine Governors serve staggered, nine-year terms. By statute, the President may remove Governors only for cause.[8]

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[2] 39 U.S.C. § 201.

[3] By statute, the Postal Service is "an independent agency of the executive branch." 39 U.S.C. § 201. Observers usually categorize it as a government corporation. See CRS Report RL30365, *Federal Government Corporations: An Overview*, by Ronald C. Moe, and U.S. General Accounting Office, *Government Corporations: Profiles of Existing Government Corporations,* GAO Report GGD-96-14, Dec. 13, 1994. On appropriations to the USPS, see CRS Report 21025, *The Postal Revenue Foregone Appropriation: Overview and Current Issues*, by Nye Stevens.

[4] On postal finance and efforts at reform, see CRS Report RL31069, *Postal Service Financial Problems and Stakeholder Proposals,* by Nye Stevens.

[5] For information on passage of P.L. 108-18, the Postal Civil Service Retirement System Reform Act of 2003, see CRS Report RL31684, *Funding Postal Service Obligations to the Civil Service Retirement System*, by Patrick Purcell and Nye Stevens.

[6] CRS Report RS21640, *The Legislative Recommendations of the President's Commission on the United States Postal Service: A Brief Overview*, by Kevin R. Kosar.

[7] 39 U.S.C. § 202(a).

[8] 39 U.S.C. § 202.

PCUSPS proposes replacing the present Board of Governors with a Board of Directors that would have broad authority to oversee postal operations. The BD would consist of 12 persons: 11 Directors and one voting member (the PG). Directors would be selected on the basis of their "significant financial and business expertise" and would serve three-year terms. The President would appoint three Directors. These three appointed Directors would then appoint eight "independent" Directors, with the concurrence of the Secretary of the Treasury. As with Governors, the Directors would choose the PG. The PG would choose the DPG, who would not sit on the board. As proposed, the President would be permitted to remove any of the presidential appointees for any reason whatsoever. The Secretary of the Treasury would be able to remove any BD-appointed members for any reason whatsoever.

The proposed BD, Directors, and their powers are constitutionally unobjectionable. Indeed, the major statutory powers of the Directors, as Table 1.1 indicates, are nearly identical to the powers of the present Governors.

Table 1.1 Major Responsibilities and Powers of the Governors and Directors[9]

Power	Governors	Directors
Hire/Replace Postmaster General	Yes	Yes
Approve annual report	Yes	Yes
Approve rate changes	Yes	Yes
Approve USPS real estate policies	Yes	Yes
Approve annual budgets, strategic plans, capital projects	Yes	Yes
Approving risk management plans	Yes	Yes
Evaluating and setting compensation of executives	Yes	Yes

The Constitution and the Proposed Board of Directors

The Appointments Clause of the Constitution (Article II, Section 2, clause 2) directs that the President

> shall nominate, and by and with the Advice and Consent of the Senate, shall appoint Ambassadors, other public Ministers and Consuls, Judges of the Supreme Court, and all other Officers of the United States, whose Appointments are not herein otherwise provided for, and which shall be established by Law, but the Congress may by Law vest the Appointment of such inferior Officers, as they think proper, in the President alone, in the Court of Law, or in the Heads of Departments.

The proposed scheme of appointment raises a fundamental issue: If the proposed Board of Directors is intended to be collectively the "operating officers" of the Postal Service, and therefore, principal "Officers of the United States," is it constitutionally permissible to have three Board members appointed by the President with the advice and consent of the Senate,

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[9] Responsibilities of boards drawn from 39 U.S.C. 202, 39 U.S.C. 205, and *Report*, p. 41.

and the remaining eight appointed by the presidentially-appointed members with the concurrence of the Secretary of the Treasury, and the Postmaster General selected by the afore-selected 11 Directors. The answer to this question requires an understanding of the background of recent developments in Appointments Clause law and its effect on the appointments authority of multi-member bodies.

As a preliminary matter, the fact that the Postal Service is no longer a department of the federal government will not serve to avoid the Appointments Clause issues here. This was made clear by the Supreme Court's ruling in *Lebron v. National Railroad Passenger Corp.*[10] In *Lebron* the issue was whether Amtrak could conduct itself in a manner that would violate the First Amendment if government engaged in the activity. Noting the various provisions of the law that defined what Amtrak was, the Court held that, while the statute was dispositive of the governmental status of the entity for purposes of matters within Congress's control, it was not determinative of the status of the entity for purposes of the Constitution's application. Because Amtrak is created by federal law, because it is governed by a Board composed largely of government appointees– that is, it is a government-created and controlled corporation– it is a government actor for purposes of the Constitution. The precise holding was that it is an agency or instrumentality of the United States for purposes of the protection of individual constitutional rights– the exact issue presented– but there is little doubt that Amtrak would be so analyzed for consideration of other constitutional provisions.[11]

Since it is evident that the Postal Service, like Amtrak, is an entity governed by the Constitution for Bill of Rights application, it must be governed as well by the structural provisions of the Constitution, such as the Appointments Clause. Otherwise, Congress would be enabled to avoid the constraints of the Constitution by creating entities that it would artificially define as outside the perimeters of the constitutional coverage. The Supreme Court had viewed this possibility with great disdain even before its ruling in *Lebron.*[12]

In developing its separation of powers jurisprudence, the Supreme Court has acknowledged that it has been animated by its concern with "encroachment and aggrandizement" by one branch against the other, and that in adopting its "flexible understanding of separation of powers" it is recognizing "Madison's teaching that the greatest security against tyranny– the accumulation of excessive authority in a single Branch– lies not in a hermetic division among the Branches, but in a carefully crafted system of

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[10] 513 U.S. 374 (1995).

[11] "We hold that where, as here, the Government creates a corporation by special law, for the furtherance of governmental objectives, and retains for itself permanent authority to appoint a majority of the directors of that corporation, the corporation is part of the Government for purposes of the First Amendment." 513 U.S. at 400.

[12] See, *e.g. Buckley v. Valeo*, 424 U.S. 1, 109-143 (1997); INS v. Chadha, 462 U.S. 714 (1986): *Metropolitan Washington Airports Authority v. CANN*, 501 U.S. 252 (1991); and see *Hechinger v. Metropolitan Washington Airports Authority*, 36 F. 97 (D.C. Cir. 1994), *cert. denied*,513 U.S. 1126 (1995). The Office of Legal Counsel of the Department is in accord with this view of *Lebron.* See, Memorandum for the General Counsels of the Federal Government from Walter Dellinger, Assistant Attorney, entitled "The Constitutional Separation of Power between the President and Congress," 26-27 (May 7, 1996) (Dellinger Opinion).

checked and balanced power within each Branch."[13] The application of this teaching is abundantly evident in the appointments process established by Article II, sec. 2, cl. 2. The Court has made clear that "The principle of separation of powers is embedded in the Appointments Clause."[14] The Appointments Clause directs that all superior officers, such as ambassadors, judges and "other Officers of the United States," must be appointed by the President with the advice and consent of the Senate. Congress may also subject any other officer of the United States ("inferior officers") to Senate confirmation but may, "as they think proper," vest the appointment of such inferior officers in the President alone, in the courts, or in the department heads. Thus the choice Congress makes with respect to the mode of appointment, of necessity, reflects a decision to impose either a heightened or lesser degree of congressional scrutiny on a nominee, or perhaps to provide a degree of insulation of the officer from the President by having him appointed (and removable) by a department head.[15] It also advances the concerns sought to be avoided by the Framers. The Court in *Freytag v. Commissioner of Internal Revenue* observed:

> The "manipulation of official appointments" had long been one of the American revolutionary generation's greatest grievances against executive power, see G. Wood, The Creation of the American Republic 1776-1787, p. 79 (1969) (Wood), because "the power of appointment to offices" was deemed "the most insidious and powerful weapon of eighteenth century despotism." *Id.*, at 143. Those who framed our Constitution addressed these concerns by carefully husbanding the appointment power to limit its diffusion. Although the debate on the Appointments Clause was brief, the sparse record indicates the Framers' determination to limit the distribution of the power of appointment. The Constitutional Convention rejected Madison's complaint that the Appointments Clause did "not go far enough if it be necessary at all." Madison urged that "Superior Officers below Heads of Departments ought in some cases to have the appointment of the lesser offices." 2 Records of the Federal Convention of 1787, pp. 627-628 (M. Farrand rev. 1966). The Framers understood, however, that by limiting the appointment power, they could ensure that those who wielded it were accountable to political force and the will of the people. Thus, the Clause bespeaks a principle of limitation by dividing the power to appoint the principal federal officers– ambassadors, ministers, heads of departments, and judges– between the Executive and Legislative Branches. See *Buckley*, 424 U.S., at 129-131. Even with respect to "inferior Officers," the Clause allows Congress only limited authority to devolve appointment power on the President, his heads of departments, and the courts of law.[16]

Congress has a choice of requiring appointment with Senate advice and consent or appointment by the President alone, by a department head, or by a court of law only with respect to inferior officers. Until very recently, Supreme Court decisions did "not set forth an exclusive criterion for distinguishing between principal and inferior officers for

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[13] *Mistretta v. United States, supra*, 488 U.S. at 380-81.

[14] *Freytag v. Commissioner of Internal Revenue*, 501 U.S. 868, 882 (1991).

[15] See, *United States v. Perkins*, 116 U.S. 483 (1886).

[16] 501 U.S. 883-84. See also *Edmond v. United States*, 520 U.S. 651, 659 (1997)("[T]he Appointment Clause of Article II is more than a matter of 'etiquette or protocol'; it is among the significant structural safeguards of the constitutional scheme.) and *Confederated Tribes of Siletz Indians of Oregon v. United States*, 110 F.3d 688, 696 (9th Cir. 1997) ("Appointments Clause serves as a guard against one branch aggrandizing its power at the expense of another.").

Appointment Clause purposes,"[17] preferring to deal with each officer on an *ad hoc* basis. In *Morrison v. Olson*, the Court found the independent counsel created by the Ethics in Government Act to be an inferior officer because she met four criteria: she was subject to removal by a higher officer (the Attorney General), she performed only limited duties, her jurisdiction was narrow, and her tenure was limited.[18] In *Edmond v. United States*, however, the Court revisited the principal/inferior officer distinction, establishing a test relying on the single criterion: whether the officer has a superior.

> Generally speaking, the term "inferior officer" connotes a relationship with some higher ranking officer or officers below the President: whether one is an "inferior" officer depends on whether one has a superior. It is not enough that other officers may be identified who formally maintain a higher rank, or possess responsibilities of a greater magnitude. If that were the intention, the Constitution might have used the phrase "lesser officer." Rather, in the context of a clause designed to preserve political accountability relative to important government assignments, we think it evident that "inferior officers" are officers whose work is directed and supervised at some level by others who were appointed by presidential nomination with the advice and consent of the Senate.[19]

Moreover, the Court held that the fact that a person exercises "significant authority pursuant to the laws of the United States marks, not the line between principal and inferior officer for Appointments Clause purposes, but rather, as we said in *Buckley*, the line between officer and non-officer. 424 U.S., at 126."[20]

Under the scheme proposed by PCUSPS, all the members of the proposed BD will be exercising "substantial authority pursuant to the laws of the United States" but only three will be appointed by the President, subject to Senate confirmation. The remaining eight will be appointed by the three presidentially-appointed Directors, with the concurrence of the Secretary of the Treasury. All 11 are intended to be equal in legal status and voting power with respect to the administration of the Postal Service, and like the present Governors, is apparently thought will be legally deemed collectively as a "head of department."[21] This presumption, however, is open to serious constitutional question. In the proposed configuration, it appears that three members of the BD are, in light of *Edmond*, superior officers, eight are inferior officers, and together as the governing body of the Postal Service, they will appoint the Postmaster General, who is clearly an inferior officer. For the reasons that follow, it is likely that a reviewing court would find the proposed scheme unconstitutional.

In order to vest appointment authority in the Board of Directors of the Postal Service it must qualify as a "Head of Department" under the Appointments Clause. Our review of the pertinent case law, and in particular the Supreme Court's recent ruling in *Edmond v. United States*, persuades us that it is likely that a reviewing court will find that the collective Board of Directors is a "Head of Department," capable of being vested with authority to appoint inferior officers.

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[17] *Edmond v. United States, supra*, 520 U.S. at 661.

[18] *Morrison*, 487 U.S. at 671 672.

[19] *Id.* at 662-63.

[20] *Id.*

[21] See *Silver v. U.S. Postal Service*, 951 F.2d 1003 (9th Cir. 1991), discussed infra.

Three judicial decisions need to be considered. In the first, *Freytag v. Commissioner of Internal Revenue*,[22] the Supreme Court unanimously upheld the authority of the Chief Judge of the Tax Court to appoint "special trial judges" to hear certain classes of cases when its workload was heavy. The entire court agreed that the Tax Court had to be either a "department" or a "court of law" in order for the Chief Judge to exercise the appointing authority. Five of the Justices found it to be a court of law, four voted to sustain the authority on the ground that it was a department. The majority opinion appeared to take a rigid view of the nature of the term "department," seeking to limit it to those governmental entities specifically identified as cabinet departments, relying on statements in late 19th and early 20th century Appointments Clause rulings by the Court:

> Confining the term "Heads of Departments" in the Appointments Clause to executive divisions like the Cabinet-level departments constrains the distribution of the appointment power just as the Commissioner's interpretation, in contrast, would diffuse it. The Cabinet-level departments are limited in number and easily identified. Their heads are subject to the exercise of political oversight and share the President's accountability to the people.
>
> Such a limiting construction also ensures that we interpret that term in the Appointments Clause consistently with its interpretation in other constitutional provisions. In *Germaine*, see 99 U.S., at 511, this Court noted that the phrase "Heads of Departments" in the Appointments Clause must be read in conjunction with the Opinion Clause of Art. II, sec. 2, cl. 1. The Opinion Clause provides that the President "may require the Opinion, in writing, of the principal Officer in each of the Executive Departments," and *Germaine* limited the meaning of "Executive Departmen[t]" to the Cabinet members.[23]

But at the same time the majority significantly qualified its broad holding by noting that: "We do not address here any question involving the appointment of an inferior officer by the head of one of the principal agencies, such as the Federal Trade Commission, the Securities and Exchange Commission, the Federal Energy Regulatory Commission, the Central Intelligence Agency, and the Federal Reserve Bank of St. Louis."[24]

The majority's qualification is likely a reaction to the strong opinion of the four concurring justices written by Justice Scalia, and is arguably meant to limit the Court's decision to the rather unique circumstances of the Article I Tax Court situation. Justice Scalia contested the majority's view that the constitutional term "department" could be equated with "cabinet-level agency."

> There is no basis in text or precedent for this position. The term "Cabinet" does not appear in the Constitution, the Founders having rejected proposals to create a Cabinet-like entity. See H. Learned, The President's Cabinet 74-94 (1912); E. Corwin, The President 97, 238-240 (5th rev. ed. 1984). The existence of a Cabinet, its membership, and its prerogatives (except to the extent the Twenty-fifth Amendment speaks to them), are entirely matters of Presidential discretion. Nor does any of our cases hold that "the Heads of Departments" are Cabinet members. In *United States v. Germaine*, 99 U.S. 508 (1879), we merely held that the Commissioner of Pensions, an official within the Interior Department, was not the head of a department. And, in

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[22] 501 U.S. 868 (1991).

[23] 501 U.S. at 886.

[24] *Id.* at 887 note 4.

> *Burnap, supra,* we held that the Bureau of Public Buildings and Grounds, a bureau within the War Department, was not a department.
>
> The Court's reliance on the Twenty-fifth Amendment is misplaced. I accept that the phrase "the principal officers of the executive departments" is limited to members of the Cabinet. It is the structural composition of the phrase, however, and not the single word "departments" which gives it that narrow meaning– "the principal officers" of the "executive departments" in gross, rather than (as in the Opinions Clause) "the principal Officer in each of the executive Departments," or (in the Appointments Clause) simply "the Heads" (not "principal Heads") "of Departments."[25]

Scalia goes on to note that so confining the scope of the term department ignores the reality of the current structure of the federal administrative bureaucracy:

> Modern practice as well as original practice refutes the distinction between Cabinet and non-Cabinet agencies. Congress has empowered non-Cabinet agencies to appoint inferior officers for quite some time. See, e.g., 47 U.S.C. § 155(f) (FCC– managing director); 15 U.S.C. § 78d(b) (Securities and Exchange Commission– "such officers ... as may be necessary"); 15 U.S.C. § 42 (Federal Trade Commission– secretary); 7 U.S.C. §4a(c) (Commodity Futures Trading Commission– general counsel). In fact, I know of very few inferior officers in the independent agencies who are appointed by the President, and of none who is appointed by the head of a Cabinet department. The Court's interpretation of "Heads of Departments" casts into doubt the validity of many appointments and a number of explicit statutory authorizations to appoint.
>
> A number of factors support the proposition that "Heads of Departments" includes the heads of all agencies immediately below the President in the organizational structure of the Executive Branch. It is quite likely that the "Departments" referred to in the Opinions Clause ("The President ... may require the Opinion, in writing, of the principal Officer in each of the executive Departments," Art. II, § 2) are the same as the "Departments" in the Appointments Clause. See *Germaine, supra,* at 511. In the former context, it seems to me, the word must reasonably be thought to include all independent establishments. The purpose of the Opinions Clause, presumably, was to assure the President's ability to get a written opinion on all important matters. But if the "Departments" it referred to were only Cabinet departments, it would not assure the current President the ability to receive a written opinion concerning the operations of the Central Intelligence Agency, an agency that is not within any department, and whose Director is not a member of the Cabinet.
>
> This evident meaning– that the term "Departments" means all independent executive establishments– is also the only construction that makes sense of Article II, § 2's sharp distinction between principal officers and inferior officers. The latter, as we have seen, can by statute be made appointable by "the President alone ... the Court of Law, or ... the Heads of Departments." Officers that are not "inferior Officers," however, must be appointed (unless the Constitution itself specifies otherwise, as it does, for example, with respect to officers of Congress) by the President, "by and with the Advice and Consent of the Senate." The obvious purpose of this scheme is to make sure that all the business of the Executive will be conducted under the supervision of officers appointed by the President with Senate approval; only officers "inferior," *i.e.*, subordinate to those can be appointed in some other fashion. If the Appointments Clause is read as I read it, all inferior officers can be made appointable by their ultimate (sub-Presidential) superiors; as petitioners would read it, only those inferior officers whose ultimate superiors happen

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[25] *Id.* at 916-917 (emphasis in original).

> to be Cabinet members can be. All the other inferior officers, if they are to be appointed by an Executive official at all, must be appointed by the President himself or (assuming cross department appointments are permissible) by a Cabinet officer who has no authority over the appointees. This seems to me a most implausible disposition, particularly since the makeup of the Cabinet is not specified in the Constitution, or indeed is the concept even mentioned. It makes no sense to create a system in which the inferior officers of the Environmental Protection Agency, for example– which may include, inter alios, bureau chiefs, the general counsel, and administrative law judges– must be appointed by the President, the courts of law, or the "Secretary of Something Else."
>
> In short, there is no reason, in text, judicial decision, history, or policy, to limit the phrase "the Heads of Departments" in the Appointments Clause to those officials who are members of the President's Cabinet. I would give the term its ordinary meaning, something which Congress has apparently been doing for decades without complaint. As an American dictionary roughly contemporaneous with adoption of the Appointments Clause provided, and as remains the case, a department is "[a] separate allotment or part of business; a distinct province, in which a class of duties are allotted to a particular person. . . ." N. Webster, American Dictionary 58 (1828). I readily acknowledge that applying this word to an entity such as the Tax Court would have seemed strange to the Founders, as it continued to seem strange to modern ears. But that is only because the Founders did not envision that an independent establishment of such small size and specialized function would be created. The Constitution is clear, I think, about the chain of appointment and supervision that it envisions: Principal officers could be permitted by law to appoint their subordinates. That should subsist, however much the nature of federal business or of federal organizational structure may alter.[26]

This lengthy quotation from Justice Scalia's opinion is justified in light of its apparent impact on two subsequent decisions. In *Silver v. U.S. Postal Service*,[27] the appeals court dealt with a challenge to the validity of the appointment of the Postmaster General by the Governors of the Postal Service. The nine Governors are appointed by the President, with Senate advice and consent, and are vested with the power to appoint (and remove) the PG and the DPG who serve with the Governors on the Board of Governors. It was argued by the appellant that a collegial body cannot be a department capable of exercising appointment authority. The court disagreed. Finding that the Postal Service was an Executive Branch entity, it utilized the *Freytag* Court's inexact suggestion that departments are "executive divisions like the Cabinet-level departments" to hold that since the Post Office prior to its reorganization in 1970 was in fact a cabinet department and the reorganization did not "fundamentally change the nature and purpose of the Postal Service," Congress's action "did not render what was once a Cabinet-level department into an entity that was not 'like a Cabinet-level department'."[28] The appeals court concluded that the nine Governors constitute the "head of department" since they are appointed by the President, can appoint and remove the PG, can revoke any authority delegated by the Board to the PG, and have the authority to designate mail classifications and to set postal rates. In view of the subordination of the PG to the Governors, and his statutory role as their managing agent, the court found him to be an inferior officer capable of being appointed by the Governor.

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[26] *Id.* at 918-920.

[27] 951 F.2d 1033 (9th Cir. 1991),

[28] 951 F.2d at 1038.

The *Silver* court appeared to reach a satisfactory and proper result but only by stretching *Freytag's* uncertain limitation on the scope of the definition of department. This uncertainty, however, appears to have been essentially dissipated by the Court's decision in *Edmond v. United States*.

Edmond involved the questions whether Congress authorized the Secretary of Transportation to appoint civilian members of the Coast Guard Court of Criminal Appeals and, if so, whether those judges are inferior officers. As previously detailed, Justice Scalia, for a unanimous court, effectively adopted his concurrence in *Freytag* with respect to the test for determining when an officer is "inferior" for constitutional purposes. "We think it evident that "inferior officers" are officers whose work is directed and supervised at some level by others who were appointed with the advice and consent of the Senate."[29] Finding that the judges in question were supervised by the General Counsel of the Department of Transportation in his capacity as Judge Advocate General and by the Court of Appeals for the Armed Forces, and that the Secretary of Transportation was authorized by Congress to appoint the judges, the Court concluded that the appointments were valid.

But Justice Scalia's opinion also pointedly diminished the majority opinion in *Freytag* in two ways: First, it limited *Freytag* to its facts: "Petitioners contend that Court of Criminal Appeals judges more closely resemble Tax Court judges –who we implied (according to petitioners) were principal officers – than they do special trial judges. We note initially that *Freytag* does not hold that Tax Court Judges are principal officers; only the appointment of special trial judges was at issue in that case." Second, and more importantly, Scalia's opinion significantly altered the *Freytag* majority's statement of the rationale for the Appointments Clause. That opinion made it evident that it was their view that at the heart of the Framers' intent was the desire to limit abuse of the appointment power by limiting its "diffusion: "Those who framed our Constitution addressed those concerns by carefully husbanding the appointment power to limit its diffusion."[30] And again, more clearly, the *Freytag* court stated:

> We cannot accept the Commissioner's assumption that every part of the Executive Branch is a department, the head of which is eligible to receive the appointment power. The Appointments Clause prevents Congress from distributing power too widely by limiting the actors in whom Congress may vest the power to appoint. The Clause reflects our Framers' conclusion that widely distributed appointment power subverts democratic government. Given the inexorable presence of the administrative state, a holding that every organ in the Executive Branch is a department would multiply indefinitely the number of actors eligible to appoint. The Framers recognized the dangers posed by an excessively diffuse appointment power and rejected efforts to expand that power. See Wood 79-80. So do we.[31]

The *Freytag* Court thus closely linked the danger of diffusion to its limitation of the scope of term "department" to Cabinet-level like entities.

The *Edmond* opinion abandons the notion of diffusion as a rationale for the Appointments Clause. Justice Scalia wrote:

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[29] *Edmond, supra* at 520 U.S. 663.

[30] 501 U.S. at 883.

[31] 501 U.S. at 885.

As we recognized in *Buckley v. Valeo*, 424 U.S. 1, 125 (1976), the Appointments Clause of Article II is more than a matter of "etiquette or protocol;" it is among the significant structural safeguards of the constitutional scheme. By vesting the President with the exclusive power to select the principal (noninferior) officers of the United States, the Appointments Clause prevents congressional encroachment upon the Executive and Judicial Branches. See id., at 128-131; Weiss, *supra*, at 183 185 (Souter, J. concurring). This disposition was also designed to assure a higher quality of appointments: the Framers anticipated that the President would be less vulnerable to interest group pressure and personal favoritism than would a collective body. "The sole and undivided responsibility of one man will naturally beget a livelier sense of duty, and a more exact regard to reputation." The Federalist No. 76, p. 387 (M. Beloff ed. 1987)(A. Hamilton); accord, 3 J. Story, Commentaries on the Constitution of the United States 374-375 (1833). The President's power to select principal officers of the United States was not left unguarded, however, as Article II further requires the "Advice and Consent of the Senate." This serves both to curb executive abuses of the appointment power, see 3 Story, at 376-377, and "to promote a judicious choice of [persons] for filling the offices of the union," The Federalist No. 76, at 386-387. By requiring the joint participation of the President and the Senate, the Appointments Clause was designed to ensure public accountability for both the making of a bad appointment and the rejection of a good one. Hamilton observed:

> "The blame of a bad nomination would fall upon the president singly and absolutely. The censure of rejecting a good one would lie entirely at the door of the Senate; aggravated by the consideration of their having counteracted the good intentions of the executive. If an ill appointment should be made, the executive for nominating, and the senate for approving, would participate, though in different degrees, in the opprobrium and disgrace." Id., No. 77, at 392.

See also 3 Story, supra, at 375 ("If [the President] should ... surrender the public patronage into the hands of profligate men, or low adventurers, it will be impossible for him long to retain public favor."[32]

While we of course eschew predictions of changes in direction of the Supreme Court, two strong indications that Justice Scalia's encompassing view of the term "department" in his *Freytag* concurrence has been adopted by the Court cannot be readily ignored. The first is the apparent abandonment of the diffusion rationale of *Freytag* as a basis for the Appointment Clause. The second is the substantial change in the composition of the Court since *Freytag* was decided. Three of the five justices making up the *Freytag* majority, Justice Blackmun, the author of the opinion, and Justices Marshall and White, have left the Court. Chief Justice Rehnquist and Justice Stevens remain, and they joined in Justice Scalia's *Edmond* opinion.

We would also note the strong support given our view of the law in this area by the Department of Justice. A 1996 opinion by then Assistant Attorney General Walter Dellinger[33] asserted the Office of Legal Counsel's agreement with the Ninth Circuit's ruling

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[32] 520 U.S. at 659-60.

[33] Dellinger Opinion, *supra* note 34.

in *Silver v. U.S. Postal Service*[34] that the Postmaster General was an inferior officer who could be appointed by the Board of Governors of the Postal Service.[35] With respect to the scope of the term "Head of Department," Dellinger noted that "[e]arlier Attorneys General had accorded the term a broad construction, citing "Authority of the Civil Service Commission to Appoint a Chief Examiner."[36] In that 1933 opinion the Attorney General noted that the Commission "ha[d] certain independent duties to perform," was "responsible only to the Chief Executive," and was "not a subordinate Commission attached to one of the so-called executive departments." As "an independent division of the Executive Branch," he concluded, the Commission was a "Department" for Appointments Clause purposes and its three commissioners, collectively, "the 'head of a Department' in the constitutional sense."[37] Dellinger went on to note that the *Freytag* Court reserved the question whether collegial entities could be vested with the power to support inferior officers. Dellinger concluded:

> We would apply the reasoning of the 1933 opinion in concluding that it is constitutional for Congress to vest the power to appoint inferior officers in the heads of the so-called independent agencies – those agencies whose heads are not subject to removal at will by the President and that conventionally are understood to be substantially free of policy direction by the President. Except for the attenuated nature of the President's supervisory authority, most of the independent agencies are clearly analogous to major executive agencies. They exercise governmental authority without being subordinated to any broader unit within the executive branch, and Congress has implicitly characterized them as "Departments" for Appointments Clause purposes by permitting their heads to appoint officials who plainly are inferior officers. Nothing in the original history of the Clause suggests any intention to exclude from the scope of the Clause separate establishments that are not subject to plenary presidential control. Finally, in reserving the question of appointments by "the head of one of the principal agencies," the *Freytag* Court itself included as examples of those agencies the "independent" FTC and the SEC as well as the clearly executive CIA, which suggests that the Court did not perceive a difference between the two types of agencies, at least in the Appointments Clause context. 501 U.S. at 887 n. 4. We see no reason to exclude the independent regulatory agencies from the class of entities that are "Departments" for Appointments Clause purposes.[38]

Finally, we would note that in the development of the proposal for the establishment of a Public Company Oversight Board, which was ultimately embodied in the Sarbanes-Oxley Act of 2002.[39] It was proposed that the chair and four members of the Oversight Board be appointed by the chairpersons of the Securities and Exchange Commission (SEC), the chairperson of the Board of Governors of the Federal Reserve Board (FRB), and the Secretary of the Treasury. Doubts were raised as to the constitutionality of having the individual chairs of the SEC and FRB appoint authorities since neither are "heads of

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[34] 951 F.2d 1033 (9th Cir. 1991), discussed above at pp. 10-11.

[35] Dellinger Opinion at 29-30, 31 note 79.

[36] 37 Op. Att'y Gen. 227 (1933).

[37] 37 Op. Att'y Gen. At 229, 231.

[38] Dellinger Opinion at 32-33 (footnotes omitted).

[39] P.L. 107-204, title I, §§ 101-109, 116 Stat. 750-771.

departments" in the constitutional sense. The enacted version placed the appointments authority in the SEC as a body.[40]

Conclusion

With due regard for the uncertainty of forecasting the outcome of Supreme Court rulings in separation of powers cases, and recognizing that the issue is not free from doubt, we believe, based upon the significant alteration to the Court's rationale for the basis of the Appointment Clause in *Edmond* from that of *Freytag*, the changed composition of the Court since the *Freytag* ruling, the supporting opinion of the Department of Justice, and the recent passage of the Sarbanes-Oxley Act of 2002, a reviewing court may well find that all members of the proposed Board of Directors of the Postal Service need to be superior officers in order for the BD to be collectively a "head of department" capable of constitutionally appointing inferior officers, such as the Postmaster General.[41]

We trust this information is helpful to you and answers your questions. If you would like any further assistance on postal governance issues, please call Morton Rosenberg at x7-7480 or Kevin R. Kosar at x7-3968.

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[40] See P.L. 107-204, title I, § 101(e).

[41] As a consequence, we do not deal with the removal power proposed for the Secretary of the Treasury. If the President appoints all 11 BD members with the advice and consent of the Senate, he has the authority to remove them at will unless Congress expressly limits that authority. See *Myers v. United States*, 212 U.S. 52 (1926); *Morrison v. Olson*, 487 U.S. 654 (1988); *Mistretta v. United States*, 488 U.S. 361 (1989).

Memorandum March 31, 2004

TO: Senate Governmental Affairs Committee
Attention: Nanci Langley

FROM: Kevin R. Kosar
Analyst in American National Government
Government and Finance Division

SUBJECT: Present and Proposed U.S. Postal Service Governance Boards

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This memorandum responds to your request concerning the legislative recommendations of the President's Commission on the United States Postal Service (PCUSPS).[1] In particular, you asked for a comparison of the present USPS governance board (i.e., Board of Governors) and that proposed by PCUSPS (Board of Directors). Table 1 compares the structures of the present and proposed boards (please see Appendix A). Table 2 compares the powers of the present and the proposed boards (please see Appendix B). Both tables quote the present law (with U.S. Code citation) and the language used by PCUSPS (with *Report* page numbers).

I hope that this memorandum is helpful to you. If you would like any further assistance on postal issues, please call me at 7-3968, or contact me by e-mail at kkosar@crs.loc.gov.

Attachment

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[1] President's Commission on the United States Postal Service, *Embracing the Future: Making the Tough Choices to Preserve Universal Mail Service: Report of the President's Commission on the United States Postal Service* (Washington: GPO, 2003). Hereinafter referred to as *Report*.

Appendix A

Table 1: Present and Proposed Governing Board of the U.S. Postal Service		
	Present Board of Governors	**Proposed Board of Directors**
Number	9 + Postmaster General and Deputy Postmaster General [39 U.S.C. § 202(a)]	11+ Postmaster General [pp. 42-43]
Appointed by	President with advice and consent of the Senate [39 U.S.C. § 202(a)]	President appoints 3 then these 3 appoint 8 [pp. 42-43]
Removal	Cause only [39 U.S.C. § 202(a)]	At will by President and Secretary of the Treasury [p. 4]
Term length	9 years [39 U.S.C.§ 202(b)]	3 years [pp. 45-46]
Partisan Composition	"Not more than 5 may be adherents of the same political party" [39 U.S.C § 202(a)]	Report does not say
Qualifications	"Represent the public interest generally"§ 202(a)] "No officer or employee of the United States may serve concurrently as a Governor" [39 U.S.C. § 205(d)]	"Significant financial and business expertise and experience managing major corporate enterprises and other large organizations" [p. 44]

Appendix B

Table 2: Major Powers of the Present and Proposed Governing Board of the U.S. Postal Service		
Powers	**Possessed by Board of Governors?**	**Possessed by Board of Directors[2]**
Generally:	"The exercise of the power of the Postal Service shall be directed by a Board of Governors" and "[t]he Board shall direct and control the expenditures and review the practices and policies of the Postal Service" [39 U.S.C. § 202(a) and 39 U.S.C. § 205(a)]	"By extracting itself from the micromanagement of postal operations, a corporate-style Board could fully devote itself, like its private sector peers, to the big picture and to critical fiduciary responsibilities. In this capacity, the Board could focus its attention and experience on mission-critical oversight, exploring key issues like: strategies to increase productivity and reduce costs; holding management accountable for achieving stated performance and service quality goals; leading risk-management efforts– particularly with regard to restoring the Service's fiscal health; and, ensuring strategies are developed to address future challenges and opportunities." [p. 36]
Appoint and replace Postmaster General and Deputy Postmaster General	Yes [39 U.S.C. § 202(d)]	Yes [p. 41]
Appoint and replace the USPS Inspector General	Yes [39 U.S.C. § 202(e)]	Report does not say [p. 101]
Approve annual report	Yes	Yes [p. 41]

[2] Complete list at *Report* p. 41.

Approve rate changes	Yes, after decision of the Postal Rate Commission and within the constraints set at [39 U.S.C. § 3625]	Yes, within bounds set by the Postal Regulatory Board [pp. 41, 57-62]
Negotiate wages, compensation, and working conditions with postal employees	Yes [Implied 39 U.S.C. §202(a) and §205(a), and within constraints set at §1003 and §12]	Yes, within employee compensation bounds determined by Postal Regulatory Board [pp. 113-123]
Evaluating and setting compensation of executives	Yes, within the constraints set at 36 U.S.C. § 1003	Yes, through Board's Compensation Committee; pay cap would also be repealed and performance-based pay instituted [pp. 41, 47, 132]
Approve USPS real estate policies	Yes [Implied at 39 U.S.C. § 202(a), § 205(a), and § 101(g)]	Yes [p. 41]
Approve annual budgets, strategic plans, capital projects	Yes [Implied at 39 U.S.C. § 202(a) and § 205(a)]	Yes [p. 41]
Approving risk management plans	Yes [Implied at 39 U.S.C. § 202(a) and § 205(a)]	Yes [p. 41]

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