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WHERE HAVE ALL THE LETTERS GONE? THE MAILING INDUSTRY AND ITS FUTURE

HEARING

BEFORE THE

SUBCOMMITTEE ON FEDERAL WORKFORCE, U.S. POSTAL SERVICE AND LABOR POLICY

OF THE

COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM

HOUSE OF REPRESENTATIVES

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WHERE HAVE ALL THE LETTERS GONE? THE MAILING INDUSTRY AND ITS FUTURE

THURSDAY, MAY 12, 2011

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON FEDERAL WORKFORCE, U.S. POSTAL SERVICE AND LABOR POLICY,
COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM,
Washington, DC.

The subcommittee met, pursuant to notice, at 9:36 a.m., in room 2247, Rayburn House Office Building, Hon. Dennis Ross (chairman of the subcommittee) presiding.

Present: Representatives Ross, Amash, Jordan, Walberg, Lynch, and Connolly.

Staff present: Gwen D'Luzansky, assistant clerk; Justin LoFranco, press assistant; Jeffrey Post, professional staff member; Peter Warren, policy director; Kenneth John, detailee; Kevin Corbin, minority staff assistant; and Mark Stephenson, minority senior policy advisor/legislative director.

Mr. ROSS. Good morning and welcome. I would like to call the Subcommittee on the Federal Workforce, U.S. Postal Service and Labor Policy to order.

Today our hearing is entitled Where Have All the Letters Gone? The Mailing Industry and Its Future.

I will begin by reading our mission statement, as we do in the full committee and subcommittees of the Oversight Committee.

We exist to secure two fundamental principles: first, Americans have a right to know that the money Washington takes from them is well spent and, second, Americans deserve an efficient, effective government that works for them. Our duty on the Oversight and Government Reform Committee is to protect these rights.

Our solemn responsibility is to hold government accountable to taxpayers, because taxpayers have a right to know what they get from their government. We will work tirelessly in partnership with citizen watchdogs to deliver the facts to the American people and bring genuine reform to the Federal bureaucracy. This is the mission of the Oversight and Government Reform Committee.

I will now start with my opening statement and then recognize the ranking member for his.

The demand for profitable first class mail continues to decline due to deep economic recession and the ever-increasing reach of the Internet and new digital media. Today's hearing presents an opportunity for lawmakers to hear important testimony from the mailing industry which has been left reeling in recent years by these devel-

opments. It is an industry whose very survival depends on a strong and profitable U.S. Postal Service.

The economic scope of the mailing industry and its impact on the U.S. economy cannot be overstated. According to industry sources, the mailing industry represents over 6 percent of the Nation's jobs and over 7 percent of the Nation's GDP. The industry touches virtually every private and public sector of the economy, accounting for approximately 8.7 million jobs and generating $1.1 trillion in economic activity in 2009, according to a 2010 jobs report sponsored by the Envelope Manufacturers Association Foundation.

Unfortunately, these numbers are down from recent years. As the recession and electronic diversion have eaten away at the mail volume, the printing, publishing, and paper industries were especially hit hard, each losing 10 percent or more of their employees from 2008 to 2009. Japs-Olson, a direct mail printing company, had to lay off nearly 300 employees between 2006 and 2010, 30 percent of its work force. The U.S. Postal work force declined only 15 percent during the same period, even as mail volume fell by 20 percent.

Even as the use of Internet and new media increases, direct mail remains an effective tool for communicating with consumers at all levels. Combining direct mail with the Internet has proven to be more effective than using either in isolation. As a result, businesses across America, large and small, are increasingly working mail-based advertising into their marketing campaigns. When mailers pay postage, that postage should be used to manage the Postal Service.

Unfortunately, the Postal Service has been unable to adapt itself quickly to a world where electronic communication is rapidly replacing physical mail. This failure of adaptation has left the Postal Service with severe excess capacity and burdensome labor costs, and put it on a trajectory that will lead to fiscal insolvency by October 2011.

The looming fiscal crisis of the Postal Service can no longer be ignored. Congress must work with businesses, unions and Postal Service itself to reform the Postal Service's business model and achieve long-term sustainability. In short, together we must all work together and right-size the postal system for the 21st century.

However, before we can discuss the details of reform, I believe it is important to make sure that we understand the challenges that the mailing industry has faced and continues to face today. That is why we are here today.

With that in mind, I thank the witnesses for appearing and I look forward to their testimony.

I now recognize the distinguished Member from Massachusetts, the ranking member, Mr. Lynch, for his opening statement.

Mr. LYNCH. Thank you, Mr. Chairman. I appreciate the courtesy.

I also want to thank our witnesses for their testimony.

Today the subcommittee will examine recent developments in the mailing industry and, in particular, the economic and business challenges faced by large volume mailers, supply companies, and mail houses. Given that the Postal Service has just released its second quarterly financial report for fiscal year 2011, and the news is not good, it is my hope that this hearing will also provide us with

an opportunity to further discuss the immediate steps that we can take in order to restore the Postal Service to financial solvency for the benefit of the entire postal community and for the country.

This week, the Postal Service reported that despite significant cost reductions and revenue-generating efforts, it ended the second quarter of fiscal year 2011 with a net loss of $2.2 billion. That compares with a net loss of $1.6 billion during the same reporting period last year. So, in addition, the Postal Service witness continued decreases in total mail volume, which dropped from 42.3 billion pieces to 41 billion pieces, a drop in mailing service revenues which declined by $568 million, and a loss in total operating revenue which fell by $500 million.

Accordingly, the Postal Service projects that it will have reached the statutory debt limit of $15 billion by the end of the current fiscal year and, absent legislative change, the Postal Service will be forced to default on its mandatory payments to the Federal Government, including a $5½ billion retiree health benefit fund payment that is due on September 30th of this year.

It is against this extraordinary financial backdrop that we must examine recent trends in the mailing industry. After all, the Postal Service is an industry cornerstone and its financial recovery is vital to addressing many of the challenges faced by other postal stakeholders, including mailers, print companies, paper businesses, and general corporations across the United States. For the sake of the Postal Service's long-term financial viability, I understand that we must give due attention to various modernization and restructuring proposals in order to ensure that the Postal Service is able to transition and grow in the digital age.

When it comes to addressing the Postal Service's current financial situation, I believe we have reached the breaking point, and we can no longer kick the can down the road. Importantly, there are certain actions that we can take in the short-term that will point the Postal Service down the right financial path. For example, we can revisit the legally mandated requirement that the Postal Service prefund 75 years of future retiree health benefits with annual payments of $5½ billion. Such a requirement is unheard of in the private sector and is not faced by any other public enterprise.

In addition, we can work to reduce the Postal Service's pension costs by addressing the significant overpayment of both its civil service retirement system and Federal employee retirement system liabilities. To this end, I have introduced legislation, H.R. 1351, that will rectify the billions of dollars in overpayments that the Postal Service has made into its civil service retirement system account. Moreover, this legislation would allow the Postal Service to use its Federal employees retirement system surplus to cover the projected cash shortfall that will result when its next retiree health benefits payment comes due in the fall.

Mr. Chairman, I look forward to our witnesses' perspectives on these issues, as well as the significant challenges that are being faced by the mailing industry generally. I thank you for holding today's hearing and I yield back the balance of my time.

Mr. ROSS. Thank you, Mr. Lynch.

Members have 7 days to submit opening statements and extraneous material for the record.

We will now welcome our panel of witnesses. Mr. Dave Riebe is president of logistics and distribution for Quad/Graphics; Mr. Jerry Cerasale is senior vice president, government affairs, for the Direct Marketing Association; Mr. Rob Melton is vice president of specialty paper for Domtar; and Mr. Todd Haycock is director, postal services, for Infotech, North America.

I welcome you all. Pursuant to our committee rules, all witnesses must be sworn in, so if you would please stand and raise your right hands.

[Witnesses sworn.]

Mr. ROSS. Thank you. Let the record reflect that all the witnesses answered in the affirmative.

Thank you and please be seated. What we are going to do is ask that you give a brief, less than 5 minute, summary of your written testimony that has been presented to the committee, and after that we will go into questions. Now I will recognize Mr. Riebe for his opening statement.

STATEMENTS OF DAVE RIEBE, PRESIDENT OF LOGISTICS AND DISTRIBUTION, QUAD/GRAPHICS; JERRY CERASALE, SENIOR VICE PRESIDENT, GOVERNMENT AFFAIRS, DIRECT MARKETING ASSOCIATION; ROB MELTON, VICE PRESIDENT OF SPECIALTY PAPER, DOMTAR; AND TODD HAYCOCK, DIRECTOR, POSTAL SERVICES, 3I INFOTECH, NORTH AMERICA

STATEMENT OF DAVE RIEBE

Mr. RIEBE. Mr. Chairman and members of the subcommittee, thank you for providing me with this opportunity to testify on behalf of Quad/Graphics. My name is Dave Riebe and I am president of logistics services for Quad/Graphics, the largest printer and mail order of magazines and catalogs in the United States. We also print and mail many other types of products.

The majority of Quad/Graphics' 142 facilities are located in the United States. On an annual basis, we partner with the Postal Service to process 16 billion pieces of mail that account for $4 billion in postage.

Economic activity and advertising spending are key drivers of the demand for printing. The global economic recession has caused a falloff in printing since 2007. Along with postage increases and alternative marketing technologies, many printing companies have failed and the industry is undergoing consolidation over capacity. My company is not immune to the continued impact of the recession. We have had to make job reductions, plant closures, and complete other restructuring actions.

Quad/Graphics is encouraged by the cost reduction realized by the Postal Service during the last 10 years, but it has not been enough to offset the decrease in mail. The Postal Service currently maintains a network that was built to support 300 billion pieces of mail annually. Total mail volume in 2011 will be closer to 170 billion. Its network needs to be right-sized despite resistance from local communities and their U.S. congressional representatives.

To survive and better serve its customers, the Postal Service must be allowed to close and consolidate processing facilities and

post offices and right-size its payroll. Quad/Graphics fully supports the Postal Service in that process.

Congress has an opportunity to help the Postal Service resolve its financial shortfall by returning to the Postal Service the more than $50 billion that have been overfunded for the civil service retirement system. This money belongs to the ratepayers since nearly all revenues of the Postal Service come from postage, of which 90 percent comes from businesses. Additionally, legislative changes are needed to modify or eliminate the mandated $5½ billion annual payment to retiree health care.

We recommend that the retirement system's overpayment should be transferred from the pension fund to the retiree health benefits fund to fully prefund those obligations. Quad/Graphics encourages Congress to act in this manner.

The Postal Service must also grow mail volume and revenue. It can do this by offering incentives to mailers. For years we have said the Post Office needs to be more businesslike. We have asked the Postal Service to be more creative in its pricing strategy and to use rightful pricing flexibility.

In 2011, we are seeing a different approach by the Postal Service to incentives that are based on value-added products and services, and partnerships with mailers. Quad/Graphics fully supports these efforts.

My company believes that print is a key element in effective marketing campaigns that use multiple forms of media. More than half of marketers are successfully utilizing three or more types of media, including print, in their marketing campaigns, according to a 2010 study. Quad/Graphics intends to keep print relevant and cost-effective as an important way for U.S. companies to conduct business. We are helping our U.S. customers reduce their postal costs through investments in our innovative distribution network.

In conclusion, if the Postal Service can manage its costs and maintain an acceptable pricing structure, its business can be maintained and growth will be realized in certain classes of mail. Quad/Graphics will continue to do everything it can to help the Postal Service be successful. We encourage Congress to do the same.

Thank you, Mr. Chairman and the subcommittee, for allowing me the opportunity to share with you information about Quad/Graphics and the role we play in the mailing industry. I would be happy to answer any questions. Thank you.

[The prepared statement of Mr. Riebe follows:]

THE COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM SUBCOMMITTEE ON FEDERAL WORKFORCE, U.S. POSTAL SERVICE AND LABOR POLICY

"Where Have All the Letters Gone? – the Mailing Industry and Its Future"
May 12, 2011

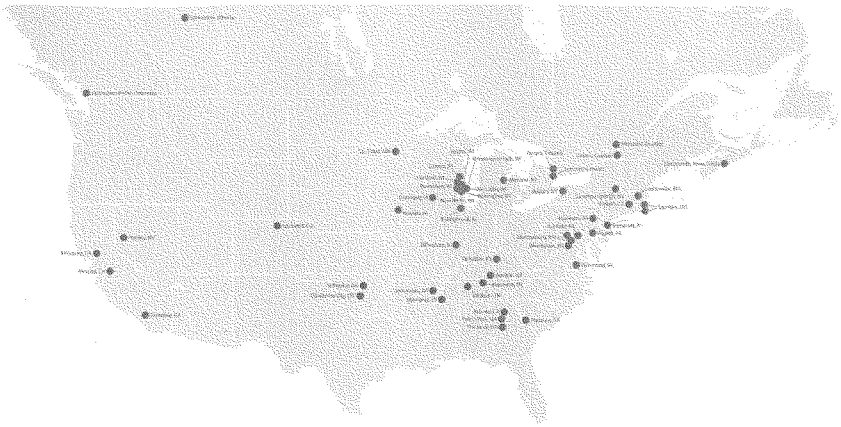
Introduction

Mr. Chairman and members of the Subcommittee, thank you for providing me with this opportunity to testify on behalf of Quad/Graphics and how technological innovation is transforming my company and the printing industry. My name is Dave Riebe and I am President of Logistics Services for Quad/Graphics, the largest printer and mailer of magazines and catalogs in the United States. I have been employed with Quad/Graphics for 27 years, all of which in the Postal and Mailing areas. In my current position, I am responsible for the mailing, shipping and distribution of all printed products Quad/Graphics produces on behalf of its customers. Quad/Graphics is a member of PostCom (Association for Postal Commerce) and I am a Director on the Board for IDEAlliance (an industry organization that identifies best practices for efficient end-to-end digital media workflows – from content creation through distribution).

About Quad/Graphics

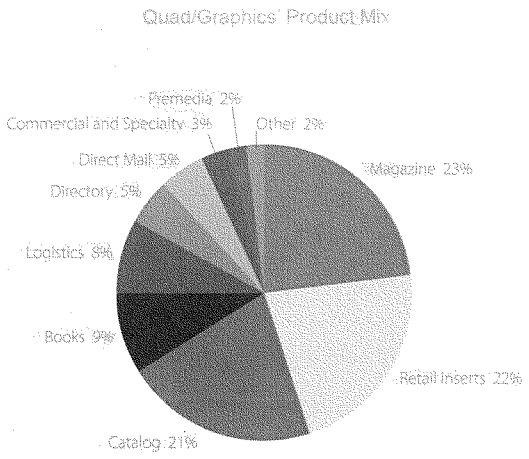
Quad/Graphics is a leading global provider of print and related services that are designed to provide complete solutions to a broad base of customers. The company's print products primarily include catalogs; consumer magazines; special interest publications; direct mail and other commercial specialty printed products; retail inserts; books; and directories. Our print-related services include binding; mailing, distribution and logistics; and data optimization and analytics services. Founded in Wisconsin in 1971, Quad/Graphics has approximately 25,000 employees in the United States, Canada, Latin America and Europe, serving a diverse base of more than 7,400 customers from 142 facilities located in 21 countries. The vast majority of the company's facilities are located in the contiguous United States. On an annual basis, we partner with the U.S. Postal Service to process 16 billion pieces of mail that account for $4 billion in postage costs.

Quad/Graphics' North American Facilities



Quad/Graphics' Client Base

Quad/Graphics has contractual relationships with leading magazine publishers, including Condé Nast, Hearst Magazines, Meredith Corporation, The National Geographic Society, Rodale Inc., The Reader's Digest Association Ltd., Time Inc., and Wenner Media LLC, and prints well-known magazines such as *Allure*, *Architectural Digest*, *GQ*, *InStyle*, *The Journal of the National Geographic Society*, *Lucky*, *People*, *Self*, *Sports Illustrated*, *Time*, *Traditional Home*, *Veranda*, and *Vogue*. Quad/Graphics prints retail newspaper inserts for The Bon-Ton Stores, Inc., J.C. Penney Company, Inc., and Target Corporation; catalogs for industry leading marketers such as Bass Pro Shops, Cabela's Incorporated, Coldwater Creek Inc., J.Crew Group, Inc., L.L. Bean, Limited Brands Inc. (Victoria's Secret), and Williams-Sonoma Inc.; and direct mail products for Guthy-Renker LLC, International Masters Publishers Inc., Publishers Clearing House, Inc., and Weight Watchers International, Inc. Our book publishing customers include Harlequin Enterprises Limited, The McGraw-Hill Companies, Inc., The Reader's Digest Association Ltd., Simon & Schuster, Inc., and Thomas Nelson, Inc.; and directory clients Dex One Corporation, Yellow Book USA, Inc., and Yellow Pages Group Limited.



The Effects of the Recession on Quad/Graphics

Demand for printed products has generally correlated with real gross domestic product growth, as economic activity and advertising spending are key drivers of demand for printing and related services. More recently, the global economic recession has caused advertisers to dramatically reduce spending. Throughout 2008 and 2009, magazine publishers faced declining advertising pages and subscription revenue; catalog marketers reduced page counts, circulation and the frequency of print campaigns; retailers curbed investments in store inventory and reduced advertising; and marketers reduced their direct mail campaigns, particularly in the banking, insurance, credit card, real estate and nonprofit industries. Decreasing print volumes caused by the impacts of the economic recession, increases in postage expenses (which significantly outpaced inflation over the last 10 years) and the increase in the use of alternative marketing technologies led many printing businesses to fail and the industry to undergo consolidation and experience overcapacity.

In 2010, the recession and excess capacity in the commercial print industry created a unique opportunity for Quad/Graphics to acquire Worldcolor, who at the time was the second largest commercial printer in North America (Quad/Graphics now occupies that position). While we expect the acquisition to strengthen Quad/Graphics' long-term viability, it has not made the company immune to the continued impact of the recession. In the best interest of our clients and shareholders, we have had to enact job

reductions; announce plant closures; shut down the former Worldcolor headquarters in Montreal; and complete other restructuring actions.

Competition in the highly fragmented printing industry remains intense as the industry is still in the process of consolidating and suffering from overcapacity. While print volumes are beginning to stabilize, the impacts of overcapacity and intense competition have led to continued downward pricing pressures.

Quad/Graphics and the Mailing Industry

Quad/Graphics' founder, the late Harry V. Quadracci, always believed it was better to lead than to follow. We have taken that approach in doing business with the Postal Service. Being one of the largest mailers in the country, Quad/Graphics has a large stake in the Postal Service's viability. We are intimately involved in working with the Postal Service in the development of new postal products and services, technology/automation, network changes, and regulation and pricing shifts. We have piloted many programs with the USPS over the years, and as a result we have a close working relationship at the headquarters, area and local levels, including USPS employees who work alongside Quad/Graphics employees onsite in our facilities. Quad/Graphics is a member of many of the postal- and mail-focused industry associations in Washington, D.C.

Managing USPS Price Increases

While Quad/Graphics doesn't pay postage for the products that we print, postal rates do have a major effect on our business and the printing industry as a whole. Each time the USPS increases rates, our clients react in a way that is detrimental to printers. Changes to regulations can have the same impact. Print buyers cut back on the number of printed pages and the frequency in which they print, and they move their business – to varying degrees – to the web. They might also reduce circulation, and in the worst-case scenario they may discontinue a publication or eliminate already planned mailings. The result is a reduction in total print volume.

It should be noted that mail volumes, particularly Standard Mail (catalogs and direct mail), began to decline in early 2007 as a result of the last postal price increase under the old postal law. Double-digit postage increases caused an immediate reaction by those mailers, as they reduced the number of mailings for the remainder of that year and cut back on the total volume of mailed copies. The recession started to add to the volume decline later that same year.

Each client of ours is challenged to find ways to reduce the impact of a rate increase. And if our clients

are challenged, that means Quad/Graphics is challenged to provide them with opportunities to reduce postage costs. Providing postal and distribution services to customers during the last decade and a half has become one of the most important and competitive aspects of the printing industry.

As a large mailer of printed products, Quad/Graphics' success is tied to the long-term success of the USPS. In the production, distribution and delivery of a publication, there are three general cost components for our clients: paper, printing and postage. Only one of those components (printing) is directly controlled by the printer. During the last 25 years, through technological advances and process changes resulting in productivity gains of more than 4 percent annually, the printing industry has been able to reduce the price for printing (when adjusted for inflation).

Meanwhile, paper prices have fluctuated during that same time, rising and falling based on supply and demand. We are currently in an upward cycle for paper prices. To ensure that Quad/Graphics provides clients with the lowest possible paper costs and highest quality products, we have dedicated staff continually working with the paper manufacturers. We pursue the most cost-effective and timely delivery of paper from the mills to our plants, and through industry initiatives, we have developed standards for managing inventories and waste. So while we don't control paper prices, industry efforts have resulted in the management of paper prices.

With the exception of the last few years since the passage of PAEA (Postal Accountability and Enhancement Act of 2006), which requires the USPS to increase prices by no more than the Consumer Price Index, postal rates have continued to rise during the same time and continue to put pressure on our clients and the practicality of hard-copy distribution through the mail. As we do with paper companies, Quad/Graphics and the printing industry work together with the Postal Service to try to maintain the lowest possible combined costs for our mutual customers, from mailpiece design to mailbox delivery. It makes no sense for the Postal Service to reduce its costs by shifting them to the printer, because at the end of the day the printer's clients will still pay a higher price. Quad/Graphics' goal in working with the Postal Service is to help it reduce its costs by providing more efficiently prepared mail while maintaining (or even lowering) our cost of production. Without these efforts, postal rates would have increased at a much higher rate.

Rightsizing the USPS

Quad/Graphics is encouraged by the cost reduction realized by the USPS during the last 10 years, but it has not been enough to offset the loss of mail volume. While the Postal Service has done much to lower

its costs through automation, transportation management and headcount reduction (through attrition), more still needs to be done. The Postal Service currently maintains a network that was built to support 300 billion pieces of mail annually. The total mail volume in 2011 will be closer to 170 billion. Its network needs to be rightsized. While it works to close and consolidate processing facilities and post offices, the USPS is met with resistance from the local communities and the U.S. Congressional representatives in those districts. The USPS must be allowed to manage its business and make the decisions needed to rightsize its processing and distribution network and payroll. We fully support the Postal Service in that process as long as it adheres to four general principles:

- Address the business needs of the USPS and its customers (mailers);
- Provide a business impact statement;
- Generate a cost/benefit analysis with respect to customers; and
- Add support for co-locating retail outlets.

Legislative Changes

While the Postal Service has worked to manage and reduce its costs, it is still faced with a very tenuous financial situation. Congress has an opportunity to help the USPS resolve its financial shortfall by returning to the USPS the more than $50 billion that has been overfunded in the Civil Service Retirement System (CSRS). That money rightfully belongs to the rate payers since nearly all revenues of the Postal Service come from user fees in the form of postage, of which 90 percent comes from businesses. Additionally, legislative changes are needed to modify or eliminate the $5.5 billion annual payment to retiree healthcare mandated by PAEA. We recommend that the CSRS overpayment should be transferred from the Pension Fund to the Retiree Health Benefits Fund to fully prefund those obligations. Such prefunding could be amortized or paid in a lump sum. Should any funds remain, they should go first to postal debt reduction, and then to retained earnings. Quad/Graphics encourages Congress to act on this matter.

Incentive Pricing for Mail Volume Growth

The USPS has realized that it cannot cut its way to prosperity. It's imperative that it also focuses on growing mail volume and revenue. Just as Quad/Graphics is bullish on print, the USPS must show that it is bullish on mail by giving incentives to companies that use the Postal Service. For years, we have told the USPS that it needs to be more "business-like." Since 2006, we have asked the USPS to be more creative in its pricing strategy and to use the pricing flexibility afforded by PAEA. In the last three years,

the USPS has responded with "sales" based on volume growth year over year, which yielded some success. In 2011, we are seeing a different approach to incentives that are based on value-added products and services and partnerships with customers and mail service providers (e.g., recently announced discounted rates for mailings that include a Quick Response Code). It is the same shared risk approach that Quad/Graphics and other companies use. The principle is simple: value-added = greater response = growth. As we know from our experiences with our customers, the risk really isn't that great when it comes to using mail to drive response from consumers. Therefore, we consider this a good example of the Postal Service using its pricing flexibility to drive the growth of mail, and Quad/Graphics fully supports these efforts.

Quad/Graphics' Strategy to Keep Print Relevant

Quad/Graphics believes that print remains the core element of effective multichannel marketing campaigns that utilize print, e-mail, mobile technology and personalized websites to engage consumers and drive higher response rates and returns for advertisers on their marketing dollars. According to a 2011 study by InfoTrends, marketers report an average response improvement of 34 percent for multichannel campaigns over single channel print-only campaigns. In addition, more than half of marketers are utilizing three or more forms of media (including print) in their marketing campaigns, according to a 2010 InfoTrends study.

Quad/Graphics intends to continue to redefine print communications as the foundation of multichannel marketing campaigns by:

- Consulting with customers on strategies for coordinating personalized, targeted print communications with other media channels including electronic media;
- Leveraging its integrated data analytics, finishing technology and logistics operations, which allow customers to create customized communications within printed products, with the objective of delivering higher responses at a lower cost; and
- Deploying its digital media capabilities, including planning, executing and monitoring e-mail campaigns, the use of personalized URLs, digital editions, and the creation and maintenance of website portals, in support of effective, print-focused marketing campaigns.

Lowering Costs and Driving Top Line Growth for Clients

In pursuit of this goal, we invest in our data analytics system and digital print platform to help our customers have a one-to-one "conversation" with each of its customers. By helping our customers

maximize their data, we enable them to reach the right recipients with the right (and relevant) message at the right time – and not to overspend on postage. Our investments in others areas such as our offset print platform and finishing area – whether to stitch, bind or polybag a unique mailpiece package for each recipient on a large mailing list (e.g., 1 million-plus names) – is further lowering the overall cost per response and generating top-line revenue for our clients.

Managing Consistent, Predictable Delivery

As stated earlier, postage rates are a significant component of many of our customers' cost structures, and they oftentimes influence the number of pieces that marketers and publishers mail. We manage the distribution of most of our customers' products to maximize efficiency and reduce costs. We help our U.S. customers significantly reduce their overall postage costs through strategic capital expenditure investments to build what we believe is one of the most efficient and innovative distribution networks in the commercial printing industry.

Innovation Is Necessary

We are very encouraged by the direction we have seen the USPS take in the last six months. The Postmaster General, Pat Donahoe, has stated his goals for the Postal Service and is already following up his words with actions. We've seen a difference in the way the USPS manages the "customer experience." Staffing reductions, which are difficult for all companies, have already begun and are expected to continue. New products and services are being developed along with the previously mentioned pricing incentive programs. Innovation is what we have been looking for from the USPS; it's what drives our business today. Jobs and the viability of the printing and mailing industries depend on it.

Conclusion

Quad/Graphics believes that print will continue to be relevant and irreplaceable and that delivering an offer through the mail is and will be the most effective way to market and sell products – our customers have the data to prove this point. We live in a multichannel world that is being transformed with technological innovation. In today's multichannel world, print remains the perfect device. It not only plays well with new media, it drives us to shop, search, view and experience. It engages, connects, inspires and moves us to act. And, in the process, it makes our lives shine a little brighter.

Consumers have choices and make decisions based primarily on price. If the Postal Service can manage its costs and maintain an acceptable pricing structure, its business can be maintained and growth will be realized in certain classes of mail. Quad/Graphics will continue to do everything it can to help the USPS

be successful. We encourage Congress to do the same. We thank the Chairman and the Subcommittee for allowing us the opportunity to share with you information about Quad/Graphics and the role we play in the mailing industry. I would be happy to answer any questions you may have.

Mr. ROSS. Thank you, Mr. Riebe.

Mr. Cerasale, you are recognized for 5 minutes.

STATEMENT OF JERRY CERASALE

Mr. CERASALE. Thank you very much. Good morning, Chairman Ross and members of the subcommittee. I am Jerry Cerasale. I am the senior vice president for government affairs for the Direct Marketing Association and we appreciate the opportunity to be here.

Director Marketing Association is a trade association for marketers and nonprofits to use communication channels to reach customers and potential donors directly. Our members represent about 70 to 80 percent of all the mail in the U.S. Postal Service and about 85 percent of Postal Service revenues.

As you said, Mr. Chairman, the Envelope Manufacturers Association has found that mail has an economic impact of $1.1 trillion, employing 8.4 million Americans. It is a very important channel of communication for our members.

Marketers have always had to adapt to technology changes to survive, and so must the Postal Service, and the Postal Service has done so in the past; you go from horse drawn carriages to Pony Express to the rail to the auto to the air, and hopefully now to electronic.

The technology really affects direct marketers and our members in four distinct ways: internally what happens at the Postal Service, internally in their own operations, customer preferences, and disposal of the mail as an important factor with technology. The Postal Service has automation and it has improved productivity.

Some of the productivity gains, some of the help has been lost, however, with requirements that are placed on mailers for preparation and IT requirements. The increased costs are exactly like a postage increase, so some of that has been lost, and we really hope that internally the Postal Service can do more with electronic means to accept the mail and take postage, to try and reduce paperwork there and make some savings.

For mailers, the new electronic communications really open up a new avenue to reach customers and donors, but it is also an avenue that we can use to complement the mail. New print technologies allow multiple pieces of mail in one print run, so we can take advantage of presort and also different demographic considerations for the recipients.

We can complement electronic shopping. Something goes in a shopping cart, it is removed from a shopping cart. You can print a postcard or a catalog with that item that was removed from the shopping cart and send it to them and increase sales with a new offer.

Members are using electronic messages to say, hey, take a look, look out for this catalog, it is coming in the mail tomorrow, and that is an important thing. Mail is used to drive traffic to Web sites. Our catalog members don't have to be told when the catalog reaches the home, they just take a look at traffic on their Web site; it is a driver to Web sites.

There are companies out there that will find out what my preference is for receiving communications, and a marketer can go to them and they will send to me an electronic message, to Dave a

mail message, so it can all be done at once. These kinds of complementary activities of electronic and print are there, and we hope it is being used. And it all depends on the return on investment, the return on investment for the advertising dollar. Wherever it is greater, that is where the marketers are going to go.

On the environmental side, it is interesting. You want to improve the value of the mail and the idea of the thoughts of the importance of mail to consumers, and by technological improvements in paper and so forth you reduce the environmental imprint. But you also have increased recycling, and we are working to try and get more and more mail recycled. The EPA said 64 percent of standard mail was recycled in 2009. We want that to increase so it increases the value of the mail in the minds of the American consumers.

There is a consumer preference. Clearly, they like bill pays and that saves marketers money. That first class mail is going to go. They are incentives. They are happy to receive the bill electronically. That saves marketers money and it meets consumer preferences. That mail is going to be gone. But banks have found electronic customers, they retain them more if they send them a piece of mail.

I know my time is just about up. And we need postal delivery.

We do applaud the Postal Service for looking for a summer sale for mail pieces that have a QR code to try and complement mobile communications with print. It all comes down to the return on investment, postage. You have to figure out the retirement and the health issue and the Postal Service has to downsize, however. We have to have that straight.

Thank you very much for your time.

[The prepared statement of Mr. Cerasale follows:]

BEFORE THE

COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM
SUBCOMMITTEE ON FEDERAL WORKFORCE, U.S. POSTAL SERVICE AND LABOR POLICY
UNITED STATES HOUSE OF REPRESENTATIVES

"WHERE HAVE ALL THE LETTERS GONE?—THE MAILING INDUSTRY AND ITS FUTURE"

MAY 12, 2011

TESTIMONY OF

JERRY CERASALE
SENIOR VICE PRESIDENT, GOVERNMENT AFFAIRS
DIRECT MARKETING ASSOCIATION, INC.

Jerry Cerasale
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Good morning, Chairman Ross and members of the Subcommittee, I am Jerry Cerasale, Senior Vice President for Government Affairs of the Direct Marketing Association, and I thank you for the opportunity to appear today concerning technology and the future of the Mail.

The Direct Marketing Association (DMA) (www.the-dma.org) is the leading global trade association of businesses and nonprofit organizations using and supporting multichannel direct marketing tools and techniques. DMA advocates standards for responsible marketing, promotes relevance as the key to reaching consumers with desirable offers, and provides cutting-edge research, education, and networking opportunities to improve results throughout the end-to-end direct marketing process. Founded in 1917, DMA today represents companies from dozens of vertical industries in the US and 48 other nations, including nearly half of the Fortune 100 companies, as well as nonprofit organizations.

In 2010, marketers—commercial and nonprofit—spent $153.3 billion on direct marketing, which accounted for 54.2% of all advertising expenditures in the United States. Measured against total U.S. sales, these advertising expenditures generated approximately $1.798 trillion in incremental sales. In 2010, direct marketing accounted for 8.3% of total U.S. gross domestic product. Also in 2010, the direct mail industry employed 9.8 million americans. For the mailing industry alone, the Envelope Manufacturers Association's Mailing Industry Job Study found the economic impact on the U.S. economy to be $1.139 trillion employing over 8.4 million Americans.

DMA members account for approximately 70% to 80% of mail volume in all classes of mail and contribute over 85% of the revenue of the U.S. Postal Service. The U.S. Mail is an important channel of communications for our members to reach customers and potential customers with relevant offers, notices on transactions and delivery of products.

Technology changes have affected the U. S. Mail and mailers since the inception of the U.S. Post Office in 1775—post roads, pony express, railroads, telegraph, telephone, automobile, air mail, radio, television, interstate highways, computers, Internet, wireless, social media, etc. Technology impacts the mailing industry in several

ways—internal Postal Service operations, internal mailer operations, disposal operations, and citizen preferences. In the final analysis, from the mail advertiser and marketer prospective, it is the cost per sale or return on investment (ROI) that drives marketing decisions, including whether or not to use the mail.

Internal Postal Service Operations

Technology and automation within the Postal Service improve worker productivity and reduce the costs of handling, sorting and delivering the mail. This reduces the need to increase postage costs and improves the ROI for mailers. Sadly, some implementation of new technology at the Postal Service has not gone smoothly. The Postal Service has placed new, and sometimes costly, preparation or IT requirements on mailers due to the new automation machinery. That has the same effect on mailers as a postage increase. Therefore, the ROI benefit from the technology sometimes is lost through new requirements.

One area where the Postal Service could implement technology that would assist mailers is in documentation for payment of postage and acceptance of mail at a postal facility. While the postal Service has made some progress in this area, there is too much paper required. The Service should move more quickly to accept computer manifests without the necessity of excess paperwork.

Internal Mailer Operations

Technology has offered marketers the ability to know their customers and donors better. Through a better understanding of customers and donors, and then applying that understanding to potential customers and donors, marketers have been able to send more relevant advertisements and offers, as well as appeals for donations, through the various channels of communications, including the mail, with the resulting improvement in ROI. Thus, the value of advertising *via* the mail has increased. This phenomenon will continue as the marketing industry shifts from broadcast to targeted advertisements provided Congress does not impose overly restrictive regulation of the collection and use of marketing data to send relevant ads, offers and appeals for donations which would dampen growth in this important segment of our economy.

Marrying these new data with the new improvements in printing technology, DMA members are able to print significantly different versions of a mail piece based upon the interests of the recipient within the same print run. This provides the ability to marketers to take advantage of the full range of presort postage discounts of the Postal Service while sending specific relevant offers to consumers—a double improvement to ROI.

Improved printing technology also provides marketers with the opportunity to complement electronic communications with print communications and *visa-versa*. DMA members can now send a catalog or a post card to a recent visitor to its web site featuring an item that the visitor had placed in the shopping cart and then had removed that item. Variable printing technology allows such a rapid response within a single print run. Virtually all DMA members using the mail include their web address on the mail piece. This drives traffic to the web site. In fact, members know when mail pieces are delivered to citizens by measuring the traffic going to their web sites. Some members send customers emails telling them that their catalog will be delivered in the next few days. They have found that this has increased customer response to the catalog. Others have reduced the size of their catalogs (and thus costs of producing and mailing) and urged recipients to go to their web site for even more products. Each marketer undertakes a detailed ROI analysis to determine the right mix of electronic and print communications.

Marketers have new options to reach customers/donors and potential customers/donors. Vendors are offering to send either an electronic or print offer to recipients based upon the recipient's communication channel preference. Thus, a DMA member may send to the vendor the recipients to whom the communication will be sent, and the vendor will send the communication *via* the channel preferred by the recipient. Thus, a single marketing campaign, by utilizing the consumer's preferred communications channel, exemplifies how U.S. Mail and electronic communications are complementary not exclusionary. This type of marketing helps eliminate the digital divide for marketing offers.

It is important to emphasize that marketers will use the channel or mix of channels that will produce the highest ROI. The U.S. Mail remains an important

communications channel for direct marketers. The use of that channel, however, will change. We do not expect mail volume to increase to 2006 levels, and, in fact, envision a slight decline in overall mail volume from today to the end of this decade. Moreover, the mix of mail volume, as noted above, will continue to change.

Disposal Options

Environmental concerns over the use of paper in the mail are discussed constantly. Technology has helped reduce the environmental footprint of mail. Paper production pollution is being reduced. Forest management is protecting old growth forests and improving the sustainability of forests used to produce paper. Paper creation from recycled fibers is improving. Printers are creating mail pieces that are 100% recyclable. Finally, mail is being recycled. The EPA recently issued its Municipal Solid Waste Report for 2009 that indicates 63.4% of Standard Mail is recycled up from 40% in 2008. DMA, the Envelope Manufacturers Association and the Magazine Publishers began a program to have their members include a recycle notice on all mail pieces. Municipalities throughout the United States are using new technology for single stream recycling which is increasing the rate of recycling. We pledge to continue to urge Americans to recycle as nearly all communities offer a recycling program. This will improve the perception of the Mail as an environmentally sound product—using a renewable source, and a recyclable product that is recycled. This increases the value of the Mail to some Americans and, thus, response rates and ROI.

Citizen Preferences

How I interact with the electronic information age pales to how my children use the online world. It is difficult to imagine how my grandchildren will interact. Marketers and nonprofits must react and adapt to the changing communication environment in order to survive. Transaction mail is one example. Many consumers prefer to receive and pay bills online. For DMA members that is a windfall. Online payment and on line bill presentment reduce costs for marketers. Since it also responds to consumer preferences, online bill presentment and payment is a win-win for marketers. That is evident in the inducements businesses offer consumers to convert to receiving bills online. Transaction

mail, whether business to business or business to consumer, is leaving the mail and converting to electronic. That mail likely is gone forever.

But, mail is important to online citizens. Banks have found that they retain online customers longer if they have sent a mail piece to the customer. Catalogers have found that over one-half of purchases made online are made by consumers who have the print catalog in front of them. Even for the electronic citizen mail increases response and ROI. Of course, ecommerce sales require delivery of product, unless the product is digitized. So the parcel delivery network of the Postal Service is very important to ecommerce consumers, particularly since both FedEx and United Parcel Service use Postal Service delivery to many residential addresses.

DMA applauds the Postal Service for its latest filing at the Postal Regulatory Commission to have a summer sale for mailers who include a QR code in their mail piece. This is an experimental product to merger print and mobile. A mobile phone app will be used to take a picture of the QR code, and the consumer will be sent to a web site for more information or purchase information. We do not know whether the product will be a success, but even if it is not, we implore the Postal Service to continue to strive to find products that directly complement electronic communication and commerce.

Businesses are offering consumers electronic mail boxes for consumers to review and then choose whether to receive the communication electronically, physically or not at all. Foreign posts are looking to establish similar products. DMA believes that the Postal Service should begin a dialogue with the private sector to look at joint efforts to provide consumers with electronic mail boxes and, possibly, addresses. The Service should leave no stone unturned in looking to joint efforts in the electronic field. However, since the Service's expertise is not in electronic communication, it should look to joint efforts with the private sector.

DMA members have found that the mail provides the most viable channel to reach out to prospective customers. All DMA members are working with email and social networks to reach non customers, but mail is a primary channel for that outreach.

Postage

As explained before the choice of communication channel depends upon the ROI. Postage is a major factor in any ROI analysis for use of the U.S. Mail. As you know, DMA believes that mailers have overpaid for postal pensions as found by the Postal Service Inspector General and the Postal Regulatory Commission, and asks that the overpayment be credited to the Postal Service obligation for retiree health benefits. This issue must be settled. Regardless of the pension and retiree health benefit outcome, the Postal Service has excess capacity that DMA members and other mailers cannot afford. The Postal Service must be afforded the latitude and must use that latitude to shrink its capacity to transport, sort and deliver 150 billion pieces of mail per year. If the Postal Service is unable to control postage rates to the rate of inflation, the ROI for mail communications will lag when compared with other communications channels.

In conclusion, the Postal Service remains, and will continue for the foreseeable future, an important channel of communication for marketers and nonprofits to reach customers and potential customers and donors. Mailers are using new technologies to merge electronic and paper communication. It is important for the Postal Service to continue to offer products that allow mailers to leverage mail and electronic communications. Congress must resolve the issue of the overpayment of pension benefits and postal retiree health benefits, and the Postal Service must right size itself. Failure will harm the ROI of mail communications and incent the shift toward electronic communications.

I thank you and look forward to any questions you may have.

Mr. ROSS. Thank you, Mr. Cerasale.

Mr. Melton, you are recognized for 5 minutes. Thank you.

STATEMENT OF ROB MELTON

Mr. MELTON. Chairman Ross, Ranking Member Lynch, and members of the subcommittee, my name is Rob Melton and I am the vice president of converting papers for Domtar. Domtar is the No. 1 producer of printing and writing papers in North America, and we employ 8,500 people across the United States and Canada. I very much appreciate the opportunity to appear before you this morning to provide a paper manufacturer's perspective on the Postal Service and the mail supply chain.

As Chairman Ross and others have mentioned this morning, the Postal Service is the engine that drives the $1.1 trillion mailing industry and provides 8.3 million jobs. As you know, the Postal Service is on the brink of insolvency. Through our active membership with EMA and customer relationships, we clearly understand the devastating impact on the mail industry if the Postal Service issues are not resolved.

Regulatory and legislative decisions that result in changes to the reliability, level of service, and cost to deliver mail all influence how our customers choose paper as their communication medium over other technology options. With approximately 30 percent of printing papers produced by our industry traveling through the mail stream, these choices have a dramatic impact on our bottom line. Uncertainty about the viability of the Postal Service will negatively impact mailer and marketer decisions to choose mail, so the urgency to restore confidence that the Postal Service is a dependable partner is great.

Our industry has been forced to respond to economic challenges. The paper industry has faced very similar challenges to the Postal Service. Structural decline in paper consumption since 2004 has averaged 4 percent per year. Part of this is due to the cyclical nature of our business and the economy, but primarily due to the changes in the way people communicate and conduct business. This has left us with excess capacity and a cost structure that cannot be supported by current or expected demand.

We have focused on cost, including making difficult decisions to close higher cost machines and facilities, in order to be more efficient and to maintain critical balance between supply and demand. Since 2007, Domtar has closed machines in Maine, Ontario, Wisconsin, and North Carolina. In fact, a few weeks ago we announced yet another pending closure of a machine in Arkansas. This is one of four machines that exist in the facilities and will have a negative impact on 110 people.

These are real jobs in rural America with wages and benefits in the six figures, jobs that are not easily replaced. To put in context, U.S. paper and paperboard has declined 10 percent over the past 3 years. Fifty-two paper mills have been closed; the paper industry work force has been reduced by 31 percent, losing nearly 400,000 jobs.

However, we have not just focused on cutting costs; we have focused on meeting the evolving needs of our customers to try to mitigate the trend of structural demand decline. Examples of this

include developing products for new print technologies that will allow marketers to digitally print images to be more customized and variable to drive response rates and improve their returns. We also are reducing overall paper consumption by making lighter weight papers that have similar attributes to current products that allow mailing costs to go down, but yet deliver the same results.

One fact that I think needs to be known is that we are fighting back. We are making sure that consumers and perception of the paper-based communications are well known. Sixty-three percent of all paper produced in our industry is recovered. That includes paper that is produced that goes into archival applications, such as books or archives, but also toilet and towel and tissue, so they are not recoverable.

We have also introduced a paper campaign, Domtar has, that heavily raises awareness of the intrinsic value and sustainable nature of paper through our Paper Because campaign. We have a Web site, PaperBecause.com, which has a great deal of information about this, and I encourage you to check it out.

One example of where Paper Because campaign is focusing is on raising awareness of consumers of some misguided attempts to convert paper-based mail recipients to electronic transactions, often without choice. Recent polling data by Wilson Research found that 66 percent of Americans preferred receiving paper bills and statements, while only 13 percent preferred electronic delivery.

Yet institutions are increasingly switching customers to electronic statements without choice and in many cases are charging for paper statements to manage their accounts. For example, the Social Security Administration is no longer mailing annual statements. While we appreciate the cost savings, this is not without risk. We don't dispute that some customers prefer electronic statements, but consumers should have a choice and shouldn't be penalized for preferring paper-based statements.

The short-term decisions that are acted upon to save the Postal Service and control costs and deal with statutory fraud, pension, and health care obligation funding rules will underestimate the impact on mail volume and may accelerate volume decline further.

The paper industry has been forced to make difficult decisions. We have the ability to adapt, to change our cost structure, to anticipate customer needs, and set about a task to resolve them. The Postal Service should do the same. Failure is not an option, as we have many industries and so many jobs depend upon the well functioning reliable Postal Service.

Thank you for your time. I am happy to answer any questions.

[The prepared statement of Mr. Melton follows:]

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Statement of
Mr. Rob Melton, Vice President of Converting Papers and Strategic Accounts
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Before the
Subcommittee on Federal Workforce, U.S. Postal Service and Labor Policy
Committee on Oversight and Government Reform
U.S. House of Representatives
Hearing: Where Have All the Letters Gone? - The Mailing Industry and Its Future

May 12, 2011

Good morning Mr. Chairman and Members of the Subcommittee. My name is Rob Melton and I am the Vice President of Converting Papers and Strategic Accounts for Domtar. I am based in Fort Mill, South Carolina. On behalf of my 8,500 colleagues who have made Domtar the largest producer (by volume) of uncoated freesheet paper (office papers, printing papers and fine writing papers) I sincerely appreciate the opportunity to testify from a paper manufacturer's perspective about our role in the supply chain of mail, the importance of mail to our industry, and review our experience in facing the economic and market challenges of paper-based communications we share with the Postal Service.

While I will be speaking from my company's perspective, I am also here on behalf of the American Forest & Paper Association and the broader context of the paper industry, as the industry has collectively faced the same challenges and difficult decisions, as we have, in addressing the prolonged economic downturn.

Domtar Corporation is the largest integrated manufacturer and marketer of uncoated freesheet paper in North America and the second largest in the world. We employ approximately 8,500 individuals in operations across the United States and Canada. Our Paper Business Segment includes the manufacturing, converting, marketing and distribution of business, commercial printing, publishing, converting and specialty papers primarily to customers in North America. I mentioned our relationship with the American Forest & Paper Association and Domtar also plays an active role in the Envelope Manufacturers' Association. We have first-hand knowledge and experience about the inextricable linkage between paper markets, a healthy Postal Service and the health of paper manufacturing.

Postal Service Concern

The financial condition of the U.S. Postal Service is of great concern to us. The USPS is an essential supply chain partner that we depend on for the timely and cost efficient delivery of communications from our customers to every household in America. Seeing approximately 30% of the printing papers our industry produces delivered through the mail, a viable Postal Service is a critical component to our success. Regulatory or legislative decisions that result in changes to the reliability, level of service, and cost to deliver mail, all influence how our customers choose paper as their communications medium over other technology options, with ultimate impacts on our volume, revenue, and ability to compete in the marketplace. Uncertainty about the viability of the Postal Service will negatively impact mailer and marketer decisions to choose mail, so the urgency to restore confidence that the Postal Service is a dependable partner is great.

Responding to economic challenges

As the Postal Service has experienced a decline in mail volume, our industry has seen a corresponding decline in markets for paper. We are very familiar with the Postal Service's experience with declining volume. Across North America Domtar and others in our industry saw market demand for printing papers slow by approximately 4% per year since 2000. Part of that decline is cyclical, as market demand for our products tends to reflect fluctuations in macroeconomic conditions, which have not been favorable over the last several years. But perhaps more importantly, the decline in communication paper demand has been driven by an underlying and persistent structural change in the way people communicate and conduct business transactions. The transition from paper-based to other forms of media marks an adverse shift in paper volume that is permanent and cannot be overcome by general economic recovery. As a result of both cyclical and structural changes on the demand side of our business, we, like the Postal Service, have been faced with excess capacity and a cost structure that cannot be supported by current and expected demand.

Since 2007 Domtar was forced to reduce our manufacturing capacity to maintain the critical balance between demand and supply. We've closed paper machines in Maine, Ontario, Wisconsin and North Carolina. Later this year we plan to shutter a machine in Arkansas. This trend has not impacted only Domtar. Others in our industry have been forced to reduce capacity. And every time a paper machine closes in North America, typically more than 100 jobs are also lost. Please understand, a job in a paper mill—most times in a rural location—with its salary and benefits package often in excess of $100,000, is not easily replaced. These are real jobs with real benefits.

Ours is an extremely capital intensive business, which requires a very high rate of capacity utilization in order to create a favorable return on the invested capital. Unfortunately, our industry has earned its cost of capital in only two of the last ten years.
In response to the challenges to our business, we as a company, and the industry as a whole have adapted to the evolving reality by consolidating operations, adjusting production capacity to more accurately match anticipated long-term demand, and increasing operational efficiency:

- We have shut down individual machines within facilities, and permanently closed entire mills.
- We have divested businesses and trailing assets that we consider non-core.
- We have shifted remaining production to the best performing facilities and rationalized those that were less cost effective.

These have been difficult, but necessary decisions for our business to be sustainable.

To put these decisions into context, U.S. production of paper and paperboard has declined 10% between 2007 and 2010, and 52 paper mills have been closed during that time period. Since 2006, the forest products industry workforce has been reduced by 31%- nearly 400,000 jobs lost, many in small rural communities that could least afford to lose them.

But our entire attention has not been focused on cutting cost. In addition to downsizing and realigning for short-term survival, we never stopped thinking about the future of the business, or the needs of our customers. We leveraged expertise to define new opportunities that will bring an increasing stream of revenue from growth areas. Our industry is using innovation to create new products with enhanced attributes to meet emerging needs of publishers, advertisers and marketers. In addition, we are finding ways to combine both paper and digital into bundled solutions that drive positive consumer responses.

Working with the direct mail industry, Domtar has pioneered some innovations to make mailing more affordable. This includes paper that retains prized printing qualities, but is lighter overall, thus allowing mailers to reap some benefits. We also have worked with the envelope industry to help envelope makers develop new products that best utilize the resource. Domtar and the paper industry have also developed solid domestic markets for some of the paper that is recovered across North America for recycling. With more than 63% of all paper manufactured on the continent recovered for recycling (and that number is 63% of ALL paper manufactured, including paper for materials that are archived, for books and includes towel and tissue product that is not suitable for recycling.)

In the wake of the current digital frenzy, my company has invested heavily in raising consumer awareness about the intrinsic value and sustainable nature of paper through our "Paper Because" campaign. Please visit our website at www.paperbecause.com for a source of great information about the critical role of paper in our everyday lives.

One area where Domtar, largely through our "Paper Because" campaign, is focusing is on the misguided attempts to convert (many times without choice) mail recipients to electronic (paperless) transactions. Our federal government is a good example of this with recent decisions by the Social Security Administration to stop mailing paper checks to benefit recipients, instead sending out debit cards to many of our nation's elderly. Or the recent decision by the Social Security Administration to end the mailing of annual statements to Social Security contributors, instead forcing contributors to access such information online. There's another example of a leading financial institution that will waive the $8.95 monthly account service charge if the customer will switch to paperless billing.

We don't dispute that many customers prefer electronic commerce, but we object to claims that going paperless is "somehow better for the environment" than receiving paper statements. Evidence shows that with the ability of a modern paper mill to self-produce all of its required energy—from elements of the waste stream—and with sustainable timber growth and harvesting now the norm, that in many instances a paper transaction actually has LESS impact on the environment than does an electronic transaction.

So while cost cutting is a necessary component in addressing financial challenges, the lessons learned in our continuing improvement process include the realization that opportunities also need to be explored and that cost cutting needs to be balanced by understanding and meeting customer needs.

Supply chain impacts of mail volume decline

The size and scope of the mailing industry in the United States remains formidable. A study commissioned earlier this year found that the mailing industry represents over 7 percent of the nation's GDP and over 6 percent of the nation's jobs. Using more specific figures, the mailing industry generated over $1 trillion in sales revenue in 2009 and supported almost 8.5 million jobs.

While the economic footprint of the mailing industry is considerable, the study confirmed a fact that we in the paper business know all too well—a steady decline in paper based communication which is directly tied to declines in mail volume. The USPS was able to counter some of this decline through delivering goods sold through e-commerce and e-commerce related advertising.

What concerns us most though is what the long term holds for both the USPS and the mailing industry in the face of chronic mail volume declines. We are concerned that the short term actions intended to address cost underestimate the impact on mail volume and may accelerate the volume decline even further. Each mail piece lost represents not just reduced postage revenue for the USPS, but the economic loss is multiplied many times throughout the entire postal value chain. We at Domtar believe that paper based communication—which marketing studies have shown time and again to be the most effective form of communicating with customers—is vital to the well-being and functionality of this supply chain and the good paying jobs it supports.

Conclusion

For its entire history, the United States Postal Service has been thread that has held the fabric of our nation together. We depend on the Postal Service to keep commerce running and we depend on the Postal Service to make sure the six-year old gets birthday greetings from Grandma and Grandpa. It is vital that we understand what is wrong and work to fix it. It isn't ONLY the mail clerks and letter carriers at risk from an unstable USPS. Indeed, other industries depend on the Postal Service in ways we strive to make sure the Subcommittee understands. The paper industry, the printing industry, the direct mail industry, the envelope industry and much more need a functioning Postal Service.

The paper industry was forced to make very difficult decisions, rationalizing assets and repurposing facilities. It's never been easy, but to survive we've developed a laser-like focus on the demands of our customers, always ensuring we meet their needs. We've invested in new technologies and worked to come up with solutions to problems our customers hadn't yet encountered. The Postal Service must take the same approach if it is to meet the challenges it currently faces.

Thank you again for the opportunity to appear before you this morning and I am happy to answer any questions.

Mr. ROSS. Thank you, Mr. Melton.

Mr. Haycock, you are recognized for 5 minutes.

STATEMENT OF TODD HAYCOCK

Mr. HAYCOCK. Good morning, Mr. Chairman and members of the committee. My name is Todd Haycock, and I am the director of postal services for 3i Infotech North America. Thank you for the opportunity to speak to you today about the changes that I have seen over the past few years in this industry and what I expect to see in the future.

As the Nation's largest outsource remittance processing provider and one of the largest first class mailers in the industry, mailing approximately half a billion mail pieces annually, the U.S. Postal Service is one of our largest partners.

It wasn't that long ago that the U.S. Postal Service was the only choice for sending and receiving bills, invoices, statements, and other transactional documents. However, this shift away from physical mail delivery to other forms of bill presentment and payment has increased pace in recent years as the number of alternative consumer billing and payment options has grown. You may be familiar with online bill presentment and payment, but other channels are emerging, such as secure email billing and payment, electronic mailboxes tied to physical street addresses, mobile presentment and payment, text-based billing and payment, and more.

The shift to alternative channels is coming at the detriment of the U.S. Postal Service-handled remittance mail, and the decline in postal remittance mail has caused 3i Infotech to close processing facilities in Tampa, Florida, Baltimore, Maryland, and Des Moines, Iowa. At the same time, other remittance processors have decided to exit the business entirely, to focus on their core financial services. We have acquired and consolidated both JP Morgan Chase's and First Tennessee Bank's remittance processing operations. I anticipate that other consolidations will continue to occur in the industry as providers find they can't maintain the scale or efficiencies necessary to remain profitable.

When paired with trend directions and analyst predictions, this continuing shift indicates that postal mail is changing from being the dominant channel for bill and payment delivery to being one of many channels available. Print bills and paper remittance exist alongside all the other electronic channels, with all measuring relatively equal levels of importance to the biller.

At 3i Infotech, we follow these trends very closely and, therefore, focus on providing new and expanded products and services to serve the changing billing and payment market. There are two sides to the equation: the bill and the payment. I see this change in how payments are being made as being driven by the consumer. The ease of making payments on a computer or on a mobile device, where a few clicks can complete the transaction, is a very appealing option to time-pressed consumers.

On the other hand, the presentment of these documents has not been subject to as vast of a shift away from the Postal Service to electronic bill delivery. I believe this is mainly because the shift is not being driven by the consumer, but by businesses. I personally

prefer to receive a paper statement and then go online to make my payment, as do many individuals that I know.

For businesses, however, there is good reason for trying to drive consumers to electronic presentment. The biggest concern is the cost. With postage rates increasing and the demand on large mailers to make expensive changes to the mailing process in order to meet changing postal requirements, businesses have to make hard choices as to where to assign their resources and capital. I am seeing more of my business customers pushing hard to drive consumers away from paper. As an example, one of my customers is currently planning on charging consumers $1.50 per month if they wish to continue to receive paper statements. And they are in the process of informing customers of this pending change.

But this organization is not alone in pushing for electronic adoption. As an example, between 2008 and 2009, one of our customers saw a 5½ percent increase in the number of monthly statements being presented electronically. In 2010, it grew to an 8.3 percent increase. This means that electronic presentment represents 11.3 percent of their total volume, and will probably grow even more in 2011.

On the other hand, one of my other customers introduced electronic presentment and payment in July 2008 and now, in March 2011, they have 147,328 consumers receiving electronic statements every month. That represents 16 percent of their total volume.

Every study and analyst group predicts that the volume of paper bills mailed through the U.S. Postal Service will continue to decline in coming years in favor of electronic alternatives. But the rate at which that decline occurs is dependent on what actions the U.S. Postal Service takes over the next couple of years. The ball is already rolling, and reversing the current trend will be difficult. However, I think if the U.S. Postal Service focused on what the mailers in the industry need, the value the mail can provide, and decreasing the complexity and cost of the mailing process, businesses will divert their capital and resources to more oppressing projects instead of trying to move away from physical mail in an effort to cut costs.

The U.S. Postal Service faces substantial changes, both financially and structurally, that need to be addressed directly. However, I have observed that the new U.S. Postal Service management team is willing to address these issues and increase their focus on mailers. This is very encouraging and I feel will be key in keeping the U.S. Postal Service as an indispensable medium of commerce and communications.

Thank you, and I look forward to your questions.

[The prepared statement of Mr. Haycock follows:]

Statement of

Todd Haycock
Director, Postal Services, 3i Infotech North America

At Hearing

"Where Have All the Letters Gone? – The Mailing Industry and Its Future."

Before the

The House Committee on Oversight and Government Reform Subcommittee on Federal Workforce, U.S. Postal Service and Labor Policy

May 12, 2011

Good Morning Mr. Chairman and members of the Committee. My name is Todd Haycock and I am the Director of Postal Services for 3i Infortech North America. Thank you for the opportunity to speak to you today about the changes that I have seen over the past few years in this industry and what I expect to see in the future.

As the nation's largest outsourced Remittance processing provider and one of the largest First-Class mailers in the industry, mailing approximately half a billion mail pieces annually, the U.S. Postal Service is one of our largest partners.

It wasn't that long ago that the U.S. Postal Service was the only choice for sending and receiving bills, invoices, statements and other transactional documents. However, the shift away from physical mail delivery to other forms

of bill presentment and payment has increased pace in recent years as the number of alternative consumer billing and payment options has grown. You may be familiar with online bill presentment and payment, but other channels are emerging such as secure email billing and payments, electronic mailboxes tied to physical street address, mobile presentment and payment, text-based billing and payments, and more.

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2011. Another one of my customers introduced Electronic Presentment and Payment in July 2008 and now, in March 2011, they have 147,328 consumers receiving electronic statements every month. That represents 16% of their total monthly volume.

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The U.S Postal Service faces substantial challenges, both financially and structurally, that need to be addressed directly. However, I have observed that the new U.S. Postal Service management team is willing to address these issues and increase their focus on mailers. This is very encouraging and I feel will be key to keeping the U.S Postal Service as an indispensable medium of commerce and communication.

Thank you. I look forward to your questions.

Mr. ROSS. Thank you, Mr. Haycock.

We will now move into the series of questions and I will recognize myself for 5 minutes.

It is interesting because we talk about the Postal Service, and I equate it to the original information highway that over the last 200 years has provided, by way of infrastructure, the flow of information to households and to businesses everywhere, and yet, over the last 20 years, predominantly with the use of the Internet, we have seen times change. But I don't think we have seen the Postal Service adapt to the market trends that have happened as a result of additional information highways that have been developed out there.

My first question would go to those that are in the manufacturing arena, or not manufacturing, but in the mailing arena.

Mr. Riebe, what percent, can you say, of your total cost is labor cost for your business?

Mr. RIEBE. I actually don't know that right off the top of my head.

Mr. ROSS. OK.

Mr. Cerasale, any of your members, do you have any idea, in your association, what percent labor cost is of the total cost?

Mr. CERASALE. I don't. I know that some other delivery companies, the labor cost is about 50 percent of their total cost.

Mr. ROSS. OK.

And, Mr. Melton, can you say?

Mr. MELTON. About one-third.

Mr. ROSS. About one-third, so about 33 percent is labor cost?

Mr. MELTON. Yes.

Mr. ROSS. Mr. Haycock.

Mr. HAYCOCK. I am not exactly sure, but I know it is less than 50 percent.

Mr. ROSS. OK. And what we have seen, the testimony here today, we have seen the U.S. Postal Service post a $2.2 billion loss for the last quarter, $2.6 billion for the year-to-date. Eighty percent of their cost is labor cost. It almost makes it cost-prohibitive to do business unless some significant systemic changes are made. Your businesses have had to make those changes.

Could you describe, Mr. Riebe, some of the changes that you have had to make? Did it include layoffs? Did it include product reformation and marketing changes or things of that nature?

Mr. RIEBE. Yes, thank you. Absolutely. When we hit the recession, we are actually in an industry that just had too much capacity, which is similar to other industries, and we have put a big focus on looking at automation, which actually reduces labor cost, and focusing on taking out equipment that is not efficient, and we have seen a reduction in the overall capacity that we have. Whereas, in some plants, we were running at 50 percent capacity, today, through consolidation, we were able to raise up the plants that weren't shut down to a capacity rate of 85 to 90 percent, which is much more economically efficient.

Mr. ROSS. Thank you.

Mr. Melton, I know you mentioned, I think, that you have had to undergo some changes, furloughs.

Mr. MELTON. Yes. In the last few years, we have laid off a significant amount of people as a result of having excess capacity and machine and facility closures, probably in the neighborhood of 3,000 people, 2,000 to 3,000 people.

Mr. ROSS. Mr. Haycock.

Mr. HAYCOCK. On our manufacturing side where we produce the invoices and statements, we have continued to increase our productivity and, thus, having to lay off employees as we increase the productivity using automation and equipment to do that. On the remittance side, we have also closed facilities and consolidated because that volume has dropped dramatically.

Mr. ROSS. Mr. Cerasale, go ahead.

Mr. CERASALE. We have seen studies show that during the recession we had a reduction within the mailing industry of about 25 percent for employees.

Mr. ROSS. And what you have done, I guess, is to adapt to a market change in order to stay solvent, and my question to each one of you, with my last minute here, is do you think that the Postal Service is doing enough to reduce their cost to avoid insolvency?

Mr. Riebe.

Mr. RIEBE. I don't, but I think they are being restricted by some outside influences as well.

Mr. ROSS. And what would those be?

Mr. RIEBE. Well, I think the ability to be able to right-size their facilities. There are definitely facilities out there that are not supporting themselves and don't make good business sense, but there is lobbying to keep them open anyway.

Mr. ROSS. I understand.

Mr. Cerasale.

Mr. CERASALE. We can't afford the excess capacity; they should be moving much more rapidly and reducing the excess capacity of the Postal Service.

Mr. ROSS. Mr. Melton.

Mr. MELTON. Agreed. It is not going to get any better, and you need to make tough decisions now to viable for the future.

Mr. ROSS. And that includes consolidation?

Mr. MELTON. Yes.

Mr. ROSS. OK.

Mr. Haycock.

Mr. HAYCOCK. It is interesting to me that years ago the cost of manufacturing the statements to present for our customers and the cost of postage were very similar, and now the differential there is much bigger. We have reduced the cost for manufacturing, but the postal costs have just continued to go up, which brings attention to those costs that businesses want to then stop mailing.

Mr. ROSS. Thank you.

I see my time is up. I now recognize the ranking member from Massachusetts, Mr. Lynch, for questions for 5 minutes.

Mr. LYNCH. Thank you, Mr. Chairman.

Mr. Riebe, I agree with a lot of your testimony; we will get to that part. I am just concerned, are you aware of the labor contract recently ratified by the American Postal Workers Union?

Mr. RIEBE. I am aware of it.

Mr. LYNCH. OK. The agreement, as you know, will reduce Postal Service labor costs by instituting a 2-year pay freeze and introduces a new career pay schedule that is below the existing schedule and substantially increases the use of non-career employees. Overall, this will result in over $3 billion in savings over the term of the agreement, and the Postal Service is looking forward to executing similar agreements with the other postal unions going forward.

Would you agree that is a significant cost saving that will result from this contract?

Mr. RIEBE. I would say it is a step in the right direction. Whether or not significant is the word I would use based on their overall labor costs, I don't know if I could get there.

Mr. LYNCH. I mean, you do agree that sorting mail, 40 billion pieces of mail, handling those packages and actually physically delivering the mail is a labor-intensive process. I don't know how you get away from that. If you are going to actually take the mail and deliver it to every home and business in America, that is labor-intensive. We don't have robots that can do that. So it is a labor-intensive business. I just don't see how you get away from that.

Let's go to something that we agree on. We have been in a debate over the overpayment made by the U.S. Postal Service for employee service that was outside of the U.S. Postal Service. This is for employees who were under the Federal system. And I agree with your testimony that the overpayments have been made and they have been funded by postal customers.

I also believe that the U.S. Postal Service employees, the postal clerks, the letter carriers, both rural and urban, our mail handlers, the supervisors and postmasters, they have earned those pension credits. So they have been shortchanged because what they are working for is being syphoned over to a Federal system. So we actually have a system right now under this current formula that the U.S. Postal Service, its customers and employees are subsidizing the Federal system.

Now, we have had a debate about this in committee and with the representatives on the Federal Government side, and they are saying that you were aware of this, that this was the plan all along, and that you all understood that you were going to be overcharged to pay for Federal employees who don't work for you. That is the response I am getting from the Federal side, and I am just curious. Were you told at the beginning that your operations were going to subsidize employees who don't work for the Postal Service? This is the relationship you have. Were you told that, Mr. Riebe?

Mr. RIEBE. Not to the best of my knowledge.

Mr. LYNCH. Mr. Cerasale.

Mr. CERASALE. No. And I wasn't around, I might look it, but I wasn't around in 1972, during that, so I am not sure what was told back then.

Mr. LYNCH. I think you were around in 1972.

Mr. CERASALE. I was around, but not in the postal area, yes.

Mr. LYNCH. All right. I was going to say you must have had a rough life. [Laughter.]

Mr. Melton? I am no spring chicken either, sir, so.

Mr. MELTON. I can say I wasn't around in 1972, but I don't believe that would be the case.

Mr. LYNCH. All right.

Mr. Haycock.

Mr. HAYCOCK. I am in agreement, I don't believe that was the case.

Mr. LYNCH. I mean, I don't get this. That is the argument that they are making, that the unions here, the mailing houses, that the formula is the formula and that you were all part of this, that you were going to subsidize the pensions for folks that don't work for you or aren't in this business relationship in the current configuration.

And I just scratch my head on how they came up with that. They cannot argue that the formula doesn't favor the Federal Government and put a greater burden on you, so they are arguing that this was the deal. I would just say, if I was sitting in your chair, I would be thinking about a lawsuit saying, wait a minute, you can't take our revenues and pay the pensions of folks that we don't have a relationship with, that aren't servicing our businesses. And I don't know if your associations have ever thought about that, but I would say now is the time to start thinking about it. I really do, because I agree with you.

I also agree on the consolidation of postal services. I am running out of time here, but we have asked, and it is not outside pressure, I don't believe, that is fighting against these closures; I think it is institutional resistance. We have 38,000 post offices in America today. We have been spending on the floor here inordinate amounts of time naming additional post offices. I think we are going to run out of names before we run out of post offices, to be honest with you.

But I agree that we have a lot of post offices out there that are close together, and we could do a better job of consolidating and closing some of those that have several close together, clustered, where it would just a matter of walking up the street and using the other post office, especially in some of our densely populated urban areas. So I am with you on that, but I have run out of time.

Thank you, Mr. Chairman. I yield back.

Mr. ROSS. Thank you, Mr. Lynch.

I now recognize the Vice Chair of the subcommittee from Michigan, Mr. Amash.

Mr. AMASH. Thank you, Mr. Chair.

Mr. Riebe, you mentioned that the total mail volume for the Postal Service is 170 billion pieces, and yet the infrastructure is built to support 300 billion pieces. Due to technology and electronic diversion, and given that mail volume has declined steadily for the past 4 years, is it safe to say that the Postal Service is wasting money to keep these systems operating?

Mr. RIEBE. In some ways they are required to keep some of these systems running. Yes, absolutely I would say that.

Mr. AMASH. Would it be sustainable for your company to have twice the production capacity that you actually needed and to spend money that you don't have on equipment that is hardly being used?

Mr. RIEBE. Absolutely not.

Mr. AMASH. And I would ask the same question of the other witnesses here.

Mr. CERASALE. There is excess capacity that should be removed, and we would not. We can't afford to maintain that excess capacity, and my members wouldn't survive if they maintained that excess capacity within their operations.

Mr. MELTON. We are in that exact same position and we have closed facilities to match our demand.

Mr. HAYCOCK. In our manufacturing, similar thing; we try to maximize the equipment we have and not have excess capacity, just to keep our efficiencies and our costs down.

Mr. AMASH. And I assume each of you would also give the recommendations to the Postal Service that we need to reduce excess capacity.

Mr. RIEBE. Yes.

Mr. CERASALE. Yes.

Mr. MELTON. Yes.

Mr. HAYCOCK. Yes.

Mr. AMASH. Mr. Riebe, you talked about prefunding health care with pension fund. Could you talk about that a little more?

Mr. RIEBE. Well, I think the belief is it is just to try to create an economic environment for the Post Office that makes them stronger. We just saw the quarterly results yesterday and trying to find a way to use that funding to give them a stronger foundation is kind of the theory behind it.

Mr. AMASH. Mr. Riebe, in your company you also print stuff that is not mailed, am I right?

Mr. RIEBE. Correct.

Mr. AMASH. And what percentage of your business would that be?

Mr. RIEBE. I would say 20 percent.

Mr. AMASH. Has that changed over the past few years?

Mr. RIEBE. Yes.

Mr. AMASH. It has gone up or down?

Mr. RIEBE. Well, it has gone up because we did a major acquisition about a year ago, so that brought some product lines into our business that weren't mailed directly.

Mr. AMASH. Mr. Cerasale, what is the level of coordination between direct marketers and the Postal Service? I guess what I am asking is do they have personnel at direct marketing facilities? What is generally the scheme?

Mr. CERASALE. For our larger members, they have a fairly significant relationship with the Postal Service, particularly at the plant level. Some of our members actually have postal operations within the plant attached, mail units there, so postal employees are there to accept the mail in the plant. Now, some of our smaller members work with customer service representatives and work through us, through the association.

We have a fairly consistent dialog with headquarters, not down in the field level here, but with headquarters of the Postal Service to try and work with them. So they have a relationship with sales forces. Many of them use suppliers like printers such as Quad, who print the mail for them, for many members, and then enter it in

the mail stream, and they have relationships with the Postal Service.

Mr. AMASH. Are there any alternatives that direct marketers use besides the Postal Service?

Mr. CERASALE. Oh, absolutely. They are multi-channeled. You use electronic, they use telephone, they use direct response TV and radio, even broadcast kind of ads. But the Internet and eventually moving to mobile. You have to use them all, or else you are going to fail.

Mr. AMASH. Mr. Melton, do you have any data to support your suggestion that using paper is actually more efficient than communicating electronically? I think you had said that people prefer paper?

Mr. MELTON. Yes. A study would show, in terms of bill presentment, that people prefer a paper-based statement rather than an electronic statement.

Mr. AMASH. How much of your paper volume is related to the Postal Service?

Mr. MELTON. Approximately 40 percent.

Mr. AMASH. And when you said that 63 percent is recoverable, what does that mean exactly, is it that it is recyclable?

Mr. MELTON. That means that of the paper that is produced in North America, 63 percent of that is recovered and brought back in to be produced into products that would be called recycled.

Mr. AMASH. So 37 percent would come from trees?

Mr. MELTON. Yes. That would be what we call virgin. But it is also renewable.

Mr. AMASH. Well, thank you. My time has expired. Thank you.

Mr. ROSS. Thank you, Mr. Amash.

We are going to go around again with a few more questions, if you all have time.

Let's talk about the electronic diversion and the Internet because for so many businesses out there the Internet has been a boost, but for, apparently, the U.S. Postal Service. So what I would I would like you to do is to kind of put on a role of you are postmaster for a day, and don't concern yourself with prefunding or retirement, OK? Let's concern ourselves with marketing ideas, innovation, and how we utilize the new avenues of information age out there, the Internet, electronic diversion, to enhance the Postal Service. I know we have talked about consolidation.

Mr. Cerasale, in some of your comments, your opening statement, you talked about how using digital media to physical media, I guess is a way to put it. The Postal Service came up with, just a couple years ago with a if it fits, it ships program. These are innovative ideas. These are entrepreneurial ideas. They come better from the marketplace than they do from government.

So what I would ask you to do, if you could, think about and explain to me or to this committee what you think could be done in conjunction with the electronic media that is out there today to enhance the Postal Service. Because even if we do take care of the prefunding and the health care thing, we still have a systemic issue that we have to deal with with the Postal Service, and that systemic issue is how do we adapt them to the changes in the marketplace, to the changes in the information age so that we don't

have to be back here again, as Congress, trying to fix something that is antiquated.

Mr. Riebe.

Mr. RIEBE. Yes. Part of it I brought up earlier. I think volume-type discounts, getting creative with pricing, incentivizing people to do more than what they are doing. From my perspective, the electronic media world is still trying to find itself, and for those of us who are on email, or if you go on the Web, we still view print as the most unintrusive way, print and mail, as the most unintrusive way to solicit somebody to buy something for you. But complement it. Let people use the Internet as the vehicle to order.

Now, that does have a negative impact on the Post Office, but the belief is that when you are on the computer, and we all get them now, you get a lot more emails than you ever used to get; you don't know how you are getting them or why you are getting them. And it is intrusive to me. Where mail, although people try to make it seem intrusive, it is really not; it comes in your mailbox and you have an opportunity to make a choice at that point. But you don't have to deal with it when you are at work, you don't have to deal with it when you are trying to relax; you deal with it at your convenience. And I still think that is a huge opportunity for the Post Office to take advantage of the fact that it is unintrusive.

Mr. ROSS. Thank you.

Mr. CERASALE. Well, I think, to start, we have to look at mobile as well, and I think that this new summer sale they had with the QR codes is a great idea for the Postal Service to look at. I do think that the Postal Service should partner with the private sector with information we have.

As I said before, if you know that I want to receive things electronically and that Dave wants to receive things in paper and Mr. Melton wants to receive things over the phone or mobile, and you have that information and to work with marketers so a marketer can go to one place and its message gets sent out to paper to me or paper to him, email to me, on the Web, through a mobile phone and have it go out. That is how you can complement communications.

We have to look at this as a whole communications structure and trying to reach customers, donors, potential customers, potential donors and try and find the preferences that the consumers want and get it out. That increases the ROI across the board.

And I think the Postal Service is part of that mix. It is going to be a changing part of the mix, and it is clearly going to change how the mail is sent in, what is sent in. It may not be a catalog, it might be a postcard, it may be a smaller catalog, different things. That type of thing, I think, is happening today, can happen today, provided Congress doesn't really hit privacy legislation that harms this kind of information. But that can happen now. That is where I would look immediately.

Mr. ROSS. Thank you.

Mr. Melton.

Mr. MELTON. I think the most unique thing about the U.S. Postal Service is it has, by mandate, the ability and requirement to reach every household in the United States, and that is a very unique infrastructure that I don't think has been exploited properly.

Mr. ROSS. I agree.

Mr. MELTON. And some of that is due to statute, the types of services and products it can offer as not to compete with the private sector, I believe. As an example, you can walk into a post office and you can buy packaging and you can buy postage, but you can't buy the service to pack that package; you need to go to a private store for that. So those are the sorts of things I think that I would look to try to change. I also think the ability to time delivery of packages with the other channels that are there are a unique opportunity, particularly with the technology that exists now to very targeted make an offer to a consumer.

Mr. ROSS. Thank you.

Mr. Haycock, briefly?

Mr. HAYCOCK. I agree with what has been said here. I think as the Postal Service focuses on what they core competency is and the value of the mail, as has been said, something along the lines of rather than paying an extra charge for 2 ounces, include that in the overall price, so 1 ounce and 2 ounce is the same price so you can add more marketing and reach those customers, as has been mentioned.

Mr. ROSS. Thank you. My time is up.

Mr. Lynch, you are recognized.

Mr. LYNCH. Thank you, Mr. Chairman.

I agree with the chairman's suggestion that we need systemic change, there is no doubt about that. And that is notwithstanding the need for a reset on the health care payments and a correction for the pension overpayment. But what those two items do, though, is buy us time, because the pension overpayment is anywhere between $55 and $75 billion, and the health benefit contribution here for retirees is $5½ billion per year.

So if we look at the trend—and I give the Postal Service some credit here, and I give the unions a lot of credit as well. If you look at what they have done, since 2008 the Postal Service has reduced its work force by 120,000 people. Since 2008 they have cut 120,000 positions.

And since 2009 it has reduced its total cost by $11 billion. Some of that is by automation, but $4 billion is savings coming from reductions in labor costs. And if you add the $3 billion in savings that is going to come out of the American Postal Workers Union recent contract going forward for the term of that contract, you are talking about $7 billion in labor cost savings and you are talking about $14 billion in reduction in cost. So they are making significant progress.

And what I am saying is with the correction to the pension overpayment and the fast-track health benefit for retiree payments, we could make much more progress if we give ourselves more time.

Now let me turn to a blatantly self-serving question. Each of you has briefly mentioned your concern for the financial condition of the Postal Service, and you mentioned the retiree health benefit payment of $5½ billion and also the Postal Service overfunding, which is anywhere between $50 and $75 billion. Last month I introduced H.R. 1351, the U.S. Postal Service Pension Obligation Recalculation and Restoration Act. It just kind of rolls right off your tongue there. [Laughter.]

The act directs the Office of Personnel Management to update the actuarial methodology to be used in allocating the CSRS retirement benefits liabilities between the U.S. Postal Service and the Federal Government. So we are trying to reset that and correct it. Any resulting surplus from this recalculation, if it is $55 or $50 or $75 billion, would then be transferred over to the Postal Service retiree health benefit fund and, further, the act would require that the Postal Service $7 billion refund would be refunded immediately and applied to the 2011 retiree health benefit payment and worker's compensation fund.

Now, it is sort of what you were talking about to start this off, Mr. Riebe. Is that something that you think would get this thing going in the right direction, get the Postal Service going in the right direction and be helpful to you and your businesses?

Mr. RIEBE. Absolutely.

Mr. LYNCH. OK.

Mr. Cerasale.

Mr. CERASALE. It would, and we support it.

Mr. LYNCH. Thank you.

Mr. Melton.

Mr. MELTON. [Remarks made off mic.]

Mr. LYNCH. Thank you.

Mr. Haycock.

Mr. HAYCOCK. Yes, it would.

Mr. LYNCH. OK, thank you. I told you it was self-serving. [Laughter.]

I appreciate that.

Look, in all seriousness, I appreciate you are in business. It takes a lot of courage to put yourself out there. You have been very helpful with the committee in giving us your perspectives. I appreciate greatly that you came here, you took the time to come here to testify before Congress to give us the perspective that you have and to provide some more impetus for change in this system that we all rely upon. So I appreciate you coming in and helping the committee with its work. Thank you.

I yield back.

Mr. ROSS. Thank you, Mr. Lynch.

I now recognize Mr. Amash for further questioning.

Mr. Amash. Thank you, Mr. Chair.

Mr. Haycock, can you tell us a little more about your company?

Mr. HAYCOCK. Sure. We are the largest outsource remittance processing provider, so all remittance statements, you send your coupon in with your check, we process those, as well as doing electronic processing of payments; and then we also do the bill presentment, so we send out bills in the mail stream, invoices, statements. We also provide other channels for our customers, electronic channels as well.

Mr. AMASH. You said the Postal Service is one of your biggest partners. What other sorts of organizations would be big partners?

Mr. HAYCOCK. Software providers that help us do operations; equipment manufacturers that provide us with equipment to do our processing.

Mr. AMASH. One of the things I found interesting, you said you were encouraged by the new Postal Service management team, but

expenses this year are up $100 million over the first 6 months. Can you explain why you are encouraged and what you think about that?

Mr. HAYCOCK. I am encouraged because what I am seeing is more customer focus. They are reaching out. They seem to be looking at new ideas, not trying to do business as usual, but looking at out-of-the-box items. I know there have been some discussions within the Postal Service about new options or new incentives and other ways of looking at adding value to the mail. So even though those haven't been implemented yet, I am encouraged that they are looking at those items, looking at the mailers.

Mr. AMASH. So is it your belief that the expenses will gradually go down as time goes on?

Mr. HAYCOCK. I don't know if that is the case.

Mr. AMASH. According to USPS data, it appears that for the first time less than half of USPS's revenues will come from first class mail this fiscal year. Ten years from now—and this is a question to all of you—do you think first class mail will continue to be the dominant revenue source at the Postal Service?

Mr. Riebe.

Mr. RIEBE. I do not.

Mr. CERASALE. I agree, it will not be the dominant revenue source.

Mr. MELTON. It will not.

Mr. HAYCOCK. Well, the current trends show that is the case. I think if we continue the same path it will definitely not. I think there is an opportunity to change that trend by accommodating the mailers that do first class mail and using that value that the mail has could slow that trend, anyway.

Mr. AMASH. And again this would be a question for all of you. Are mailers preparing for a post-first class mail world and do you think that the Postal Service's current business model will work if first class declines from 78 billion pieces in 2010 to 46 billion pieces in 2020?

Mr. RIEBE. I do not.

Mr. CERASALE. I believe it has to change.

Mr. AMASH. And do you think mailers are prepared for this world?

Mr. RIEBE. It depends how it changes.

Mr. CERASALE. They are prepared in the sense of looking a return on investment, and they are going to use alternative means if it is not there. Mailers are prepared, marketers are prepared to use the mail, and advertising mail is going to be dominant. The Postal Service has to downsize to meet that new need, its marketers needs, and they will remain a viable channel for us. But they are prepared in the sense of they will go to alternative means if the return is better elsewhere. It is not at the moment, that is why they are in the mail. The mail is still a good response vehicle. But that will change if the Postal Service doesn't change on its own.

Mr. MELTON. Yes, I think that the standard mail side of it will continue to grow and I think the value of that has been proven, and the returns are there and I think it is only going to improve as technology allows them to be more targeted. I also believe that on the statement presentment side that there is an opportunity for

transpromotional advertising and goes along with the bill. You have a relationship with a customer already, the opportunity to sell them more is there and technology is allowing that.

Mr. HAYCOCK. In my business, that is what we do, is first class mail, and I do see that shift away from first class mail happening, and for my business, we offer other alternatives, other channels and opportunity for our customers to choose which channels they want to use. And we have to kind of go down that path in order for us to keep a viable business.

Mr. AMASH. Thank you. I am going to yield back.

Mr. ROSS. Thank you.

I now recognize the gentleman from Virginia, Mr. Connolly. Welcome.

Mr. CONNOLLY. Thank you, Mr. Chairman.

I would sort of like to pick up on where our colleague from Michigan left off. You know, in and of itself, the decline in first class mail doesn't mean anything. There were companies in 1900 who were making a lot of profit producing buggy whips, but if they didn't see the future, they were in trouble, even though in 1900 it looked like a profitable business for quite some time to come. The fact that we have a shifting market, in and of itself, the question is can we create, as you suggest, a new business model—by the way, I have some legislation I hope you will look at that does just that—that helps take cognizance of the changes in the market.

For example, companies like Amazon.com have become very profitable with online sales. They have to, however, get those products to market. And the Postal Service, 1 percent now of its business is packages like that, but it is 2 percent of its profit. So the margin is pretty good.

Mr. Melton, Mr. Haycock, do you think that there could be a future in expanding that kind of niche business for the Postal Service at some level of profitability?

Mr. MELTON. Absolutely. And I think there are opportunities to perhaps share some routes, as an example. If we are going to reach every household in the United States, you might as well take advantage of sharing some of those routes.

Mr. CONNOLLY. If we are serious about making the Postal Service successful as we move forward in this century—and I know my colleague, Mr. Lynch, has introduced legislation I certainly support and supported in the previous Congress in this whole prefunding issue, which is very substantial and it is an onus on the Postal Service that is unique to the Postal Service, Congress does not require it of anyone else, and it is costing them billions of dollars every year. So when we look at a figure that says you are losing $7 billion a year, but if we amortized, for example, the estimated overpayments and continuing 100 percent requirement, frankly, we could probably substantially change that number in a positive direction.

But beyond that, that buys us some time, substantial amount of time in which to figure out the business model. Mr. Melton, you mentioned something about why not let the Postal Service, for example, engage in packaging services. Is that correct?

Mr. MELTON. Yes.

Mr. CONNOLLY. Are there other areas anyone on the panel thinks that might be something that come into the Postal Service as a niche market for them or something they ought to get into? And before you answer, I point out Congress is part of the problem. The 2006 legislation, God knoweth why, proscribes the Postal Service from entering certain kinds of business. Given the situation were are in today, if we really mean what we say about caring about its fiscal plight, why wouldn't we rescind those restrictions and let 1,000 flowers bloom to see what works?

Mr. Melton.

Mr. MELTON. Yes, I agree it is tough to run a business when you have restrictions on controlling your costs and also limited in meeting some market demands that may be there. So I would encourage that those things are looked at.

Mr. CONNOLLY. Mr. Haycock.

Mr. HAYCOCK. The only concern I would have about opening everything up would be losing focus on their core, what they do best at. Now, I would agree that if there are other areas that could use that core business and utilize their infrastructure, what they have today, then I would be open definitely for them to do that.

Mr. CONNOLLY. Sure. But can I just engage you on that? I have a very large postal office in my district, in Merrifield, it is sort of a regional post office. People go there all the time for all kinds of things. Why not let them have a Starbucks outlet there so that people, when they go there to do their other core business, can also get a cup of coffee? You are able to do that at the grocery store these days. You are also able to do banking at the grocery store, even though neither one of those are core missions of the grocery store. But in terms of convenience and making it a focal point in terms of retail activity, you enhance the viability of the enterprise.

Wouldn't that be some kind of model we ought to be looking at for the Postal Service?

Mr. HAYCOCK. That seems very reasonable, absolutely.

Mr. CONNOLLY. Thank you.

Anyone else on the panel? I have 30 seconds left.

Mr. CERASALE. I think co-location, as you explained, is valuable. They can even try and locate it at another facility and have a post office there and open more times. You also have the ability to co-locate State and local government things in a government facility there as well, so that is an area, looking at the 38,000 of them, or it could be less, postal facilities, you can try and enhance that real estate footprint.

Mr. CONNOLLY. Mr. Chairman, my time is up, but the gentleman makes a very good point I commend to my colleagues, because as someone who ran a local government for a long time, historically, a lot of post offices have the stovepipe model; we are separate unto ourselves and sovereign, and don't bother us. And a new model would suggest this kind of co-location with State and local services and government, there could be cost-sharing, there could be huge efficiencies, and again you are making that post office, which already exists, a more focal point for the community, which, by the way, my legislation also addresses.

Thank you.

Mr. ROSS. Thank you, Mr. Connolly. I appreciate that input.

I want to thank the panel members for being here today. We are grateful for your input and this subcommittee now stands adjourned. Thank you.

[Whereupon, at 10:45 a.m., the subcommittee was adjourned.]

[The prepared statements of Hon. Justin Amash and Hon. Gerald E. Connolly, and additional information submitted for the hearing record follow:]

COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM

SUBCOMMITTEE ON FEDERAL WORKFORCE, USPS, AND LABOR POLICY

"WHERE HAVE ALL THE LETTERS GONE?"

5/12/2011

OPENING STATEMENT FOR REP. JUSTIN AMASH (MI-03)

I'd like to thank Chairman Ross for holding this hearing today, and I would like to thank all of the witnesses for their testimony and willingness to participate. We are all aware that the Postal Service is in the middle of a fiscal crisis.

Today, we will look at private sector entities that have had to make significant adjustments to their businesses in order to survive. Downsizing, restructuring, and reduction of capacity were painful, but necessary actions that have kept these businesses afloat.

The purpose of today's hearing is to examine the current state of the mailing industry, and just as important, its future. I would like to mention, however, the Postal Service's alleged overpayment to the Civil Service Retirement System. At our first subcommittee hearing, which took place in March, I submitted a letter for the record. This letter, written from the Office of Personnel Management and sent to then-Postmaster General Jack Potter, explains that after careful analysis by OPM and the CSRS Board of Actuaries, there is no overpayment to the retirement fund. OPM rejected the Postal Service's request to recalculate the formula and refund a portion of the money paid to CSRS.

The issue of an alleged overpayment, which should have been settled years ago, has been used by many as a distraction from the real issue at hand. The Postal Service needs to make serious adjustments to its business model. It needs to make the tough choices that the rest of the nation had to make in order to survive the recession.

I look forward to hearing from our witnesses, and I hope we can learn from their experiences as the Postal Service attempts to develop a new, sustainable business model. This will be no easy task for the Postal Service, but we cannot keep kicking the can down the road. We need drastic changes, and we need them now. I yield back.

Statement of Congressman Gerald E. Connolly
Subcommittee on Federal Workforce and the Postal Service
May 12th, 2011

Thank you, Chairman Ross for inviting members of the mailing industry to discuss reform Postal Service reform. The Postal Service plays a vital role in American life, whether by delivering medicine for the elderly or by linking communities and individuals together. However, one of its most tangible contributions to our economy is its service as the foundation of the mailing industry. By providing low cost mail delivery to every home in America, the Postal Service has created a *trillion* dollar mailing industry that includes a wide range of businesses from paper manufacturers to direct mailers.

The written testimony submitted by today's witnesses suggests substantial elasticity of demand for Postal Services. Our witnesses suggested that some recent declines in mail volume were associated with higher postage rates set in 2007 in addition to the recession. If demand for Postal services is elastic, then we must ask ourselves how we can maintain low postage rates. Maintaining high volume would seem to be a central part of that equation. As consultants for the Postal Service found in their recent analysis of postal business models, most other countries have less extensive service, lower mail volumes, and higher per unit prices than the Postal Service. What may be more of a niche market in Europe has price points that make it popularly accessible here in the United States, whether for prescription drug shipments or birthday cards. If there is a relationship between mail volume and postage prices then we must examine proposals to curtail Postal service very carefully, lest we inadvertently contribute to curtailment of service and lost economies of scale. Of course, as the witnesses suggested, the logical first step to reform the Postal Service is to pass Mr. Lynch's bill and correct the pension overpayment made by Postal Service employees. As Jerry Cerasale of the Direct Marketing Association noted, "Congress must resolve the issue of the overpayment of pension benefits and postal retiree health benefits."

As we examine ways to maintain mail volume we need to recognize that not all volume is the same. Parcels and first class mail have high profit margins for the Postal Service while flats do not. We need to give the Postal Service flexibility to adjust prices in a manner that protects it from substantial revenue losses amongst certain classes of mail. At the same time, we should be wary of proposals that would increase the margins of mail classes that are already profitable. Such increases could drive away customers, reducing future volume and revenue. Finally, we should seek to understand how the Postal Service can expand existing streams of revenue and identify new ones to offset revenue lost as a result of electronic diversion of bill payment. Postal income could continue to go up as a result of parcel shipments related to online retailing, so the Postal Service should have the ability to continue dominating this high margin sector of the mailing market. In addition, the Postal Service should have the authority to conduct package services, install remote vehicle sensors, and engage in other innovative activities that could generate new revenue.

Thank you again for holding this hearing, Chairman Ross. I hope that we will move forward in the spirit of this statement from Mr. Riebe: "Innovation is what we have been looking for from the USPS." If we fix pension overpayment and retirement prefunding problems and give the Postal Service the ability to raise new revenue we should be able to look forward to another century of mail service which creates myriad business opportunities for American entrepreneurs.

Questions for Jerry Ceresale
Senior Vice President, Government Affairs
Direct Marketing Association

Rep. Ross
Committee on Oversight and Government Reform
Subcommittee on Federal Workforce, U.S. Postal Service and Labor Policy

Hearing on "Where Have All the Letters Gone? – The Mailing Industry and Its Future"

1. **Can you expand on your testimony to describe the tough decisions that the mailing industry has made to eliminate excess capacity, such as layoffs and plant closures? Are these the types of decisions that the Postal Service needs to make?**

A. In the 2009-2010 edition of DMA's *Power of Direct Marketing* that measures the impact of direct marketing on the Economy, employment and sales statistics for the "direct mail" industry declined 11% and 15%, respectfully, from 2008 to 2009. Although sales improved for 2010, employment remained unchanged.

It is not surprising, therefore, to find a significant number of plant closures, consolidations and bankruptcies through the industry supply chain. For example:

- Prior to its bankruptcy, National Envelope closed 7 of its plants. The Gore Group which purchased the remnants of National Envelope, closed an additional half dozen plants.
- Franklin, Grays Harbor, Katahdin and Vantec are but a few of the paper mills that have closed plants in response to declining demand.
- The printing industry has seen a number of plant closing in the past several years and major consolidations---most notably the purchase of Quebecor World by Quad Graphics.
- DMA members report reducing workforce by 12% to 50%.

All of the above have been a direct result of the reduction in mail volume by direct mail marketers as they all but eliminated prospecting and reduced their advertising expenditures. Several members have eliminated their catalog offers all together. In turn direct mail companies have gone through several iterations of belt tightening. The cross-section of their cuts is well documented in affidavits submitted to the Postal Regulatory Commission in conjunction with comments by the Affordable Mail Alliance in the 2010 exigent rate increase request.

The Postal Service must take similar actions. It has taken steps to control its costs, but much more is needed much more quickly. However, the Postal Service has faced a number of impediments. The Postal Service has constraints on benefits it may offer its

employees. As a government entity, it is more susceptible to public and political pressure than are private sector entities concerning closing or consolidating facilities. DMA urges the Postal Service to move forward quickly to resize its network of facilities and asks Congress to allow the Postal Service to implement those changes immediately by rejecting any legislative attempts to prevent resizing the network.

2. **What other actions has the mailing industry taken in recent years to control compensation and benefit costs? Have employees in the mailing industry had to make sacrifices?**

A. In addition to the steps outlined in the answer to your first question, employees in the mailing industry have had wages frozen in most instances and reduced in others. Benefit packages have been reduced with employees having to pay for a greater percentage of health benefits. Some benefits have been eliminated. For those employees whose jobs had not been eliminated their benefits have been reduced.

3. **Based on your knowledge of the postal system, has the large decline in mail volume created substantial excess capacity in the Postal Service's workforce and infrastructure?**

A. There can be little question but that the decline in mail volume has resulted in excess capacity in both the Postal Service's physical plants and its workforce. The Postal Service through attrition has reduced its employee complement significantly. Sadly, much more must be done and quickly. The Postal Service network can deliver over 250 billion pieces of mail per year. Volume for this year is around 170 billion pieces of mail. That excess capacity must be shed. Mailers cannot afford to support that excess capacity through postage. Moreover, as I stated in my testimony, despite a heavy investment in automated mail sorting equipment, efforts over the past several years to trim its workforce and the decline in mail volume labor still accounts for roughly 80% of total operating cost.

4. **Do you think that the Postal Service is doing everything it can within its existing legislative authority to cut costs?**

A. In the past several years the Postal Service has become much more focused on right-sizing its physical plant and workforce. However, it has not moved as quickly as it must closing and consolidating its mail processing facilities. With the outlook for continued mail volume declines through 2020, the list of completed plant consolidations should be quite long. Sadly, it is not. As I stated in question 1, however, it is imperative that Congress not interfere with the Postal Service's plans to consolidate mail processing facilities. It is also imperative that the Postal Service not pull back from those plans in the face of perceived political pressure.

5. **You testified that marketers will use the advertising channel or mix of channels that will produce the highest return on investment, including the U.S. mail and electronic communications. In that regard, you stated that the use of mail for direct**

marketing will change. What changes do you foresee, and how might that effect the volume and weight of advertising mail?

A. There is general agreement in the mailing industry that the mix of mail will shift to smaller, lighter weight pieces. There may also be a change in the frequency of mailings.

In 2006 the Postal Service challenged mailers of catalogs and other flat-shaped mail to avoid large postage increases by trimming the size of their mail pieces to "booklet" size to qualify for the lower letter rates. Many mailers did that. They have also shifted to lighter weight paper for their mail. On the other hand, the Postal Service is shifting its postage from a weight-based to shape-based system. This might encourage some mailers to increase the weight (not shape-size) of their mail.

DMA also sees a shift in the use of the mail to complement other channels of marketing and retail outlets. Some members have shifted their mail to post cards announcing offers to be found on the marketer's web site. Other members are sending small catalogs or post cards to web customers who had removed products from their on-line shopping cart. In addition multi-channel marketers have segmented that customer base by how and where they buy and have shifted the timing of mailing and to whom they mail. For example, those who purchase *via* the toll-free telephone number listed in a catalog might receive a larger catalog than customers who purchase through the Internet.

The mail will remain an important cog in multichannel marketing campaigns, but it will become more complementary of other channels.

Questions for Dave Riebe
President of Logistics Services
Quad/Graphics

Rep. Ross
Committee on Oversight and Government Reform
Subcommittee on Federal Workforce, U.S. Postal Service and Labor Policy

Hearing on "Where Have All the Letters Gone? – The Mailing Industry and Its Future"

1. Can you expand on your testimony to describe the tough decisions that your company has made to eliminate excess capacity, such as layoffs and plant closures?

As I indicated in my testimony, excess capacity at Quad/Graphics and in the commercial printing industry as a whole is mostly the result of decreasing print volumes caused by the impacts of the global recession; increases in postage expenses (which significantly outpaced inflation over the last 10 years); and the increase in the use of alternative marketing technologies. Deflated pricing levels will continue to negatively affect the printing industry and fuel further consolidation so long as there is overcapacity.

Acting in the best long-term interest of our clients and shareholders, Quad/Graphics has over the course of the last 11 months announced or completed 10 North American (U.S. and Canada) plant closures, including three announced since the beginning of 2011. The impact of these and other restructuring actions will result in the closure of more than 5 million square feet of manufacturing, warehousing and office space, and a gross reduction of 5,000 employees. Currently, the company has realized a net reduction of approximately 3,300 full-time equivalent workers. (Note: Jobs have been added at select facilities where volume has been moved from shuttered plants).

Quad/Graphics has also enacted hundreds of employee layoffs and shut down various manufacturing equipment at many of its U.S. and Canadian plants that otherwise remain fully operational.

2. What other actions has your company taken in recent years to control compensation and benefits costs? Have your employees had to make sacrifices?

Quad/Graphics has been proactive and aggressive in controlling compensation and benefits costs. Many of the actions the company has taken in this regard have required sacrifices on the part of employees.

In the past year alone, Quad/Graphics has consolidated benefits-related vendors, particularly those for healthcare, pharmacy and employee assistance (which helps employees deal with personal problems that might adversely impact their work performance, health or well-being). It should be noted that Quad/Graphics, through its organically grown QuadMed subsidiary, employs its own medical staff, operates its own laboratory, pharmacy, fitness and rehabilitation centers, and contracts with local hospitals for specialized and advanced care. This progressive approach to bringing healthcare services in-house significantly lowers the company's costs.

Quad/Graphics has also consolidated, reduced and eliminated post-retirement benefits plans. This includes transferring the company's pension plan from a Defined Benefits Plan (DBP) to a Defined Contribution Plan (DCP). The DCP links pension disbursements to company profitability, whereas the DBP links pension payouts to a predetermined dollar amount regardless of the company's financial performance.

Additional ways Quad/Graphics has controlled compensation and benefits costs in recent years is through rightsizing headcount; freezing wages; tightly managing labor to avoid costly overtime; investing in automation on the manufacturing floor (which reduces labor); and increasing employee co-pays for healthcare and related services.

Controlling compensation and benefits costs is just one of the ways in which Quad/Graphics is reducing overall internal operating costs. It is this larger scale cost reduction (through sustainable initiatives such as Lean Manufacturing) that drives the company's pursuit of being the lowest-cost provider, which is especially important during this time of excess capacity and economic recession.

3. Based on your knowledge of the postal system, has the large decline in mail volume created substantial excess capacity in the postal workforce and infrastructure?

Without question, yes. As mentioned in my testimony, the Postal Service's processing and distribution network has the capacity to manage 300 billion pieces of mail annually, while mail volume in 2011 is projected to be only about 170 billion pieces. Unfortunately, the USPS is now projecting even lower total mail volume for FY2012. As a result:

- Automated processing equipment is under-utilized.
- There is excess capacity in transportation.
- Postal Service headcount is significantly higher than needed.
- There is a heightened need to close and/or consolidate postal processing facilities.

While no one wants to see postal facilities close and individuals lose their jobs, Quad/Graphics has taken such actions in the last few years for the long-term benefit of the company and its shareholders. And if capacity is not taken out of the Postal Service, costs will continue to rise, and Quad/Graphics and the mailing industry will continue to "pay the price" through the loss of private-sector jobs.

4. As the volume of profitable First Class Mail continues to decline, how important is it for the Postal Service to rightsize its workforce and infrastructure? Does the rate of progress in this regard need to be accelerated?

Unless the Postal Service can replace the loss of First Class Mail with other products, rightsizing the organization is the only option. The best-case scenario would be to continue rightsizing while creating more revenue-generating ideas (products and services). I applaud the Postal Service for its renewed efforts in this regard.

However, Standard Mail and Parcels (Package/Shipping Services) are the only products that are realizing positive growth in the last few quarters. Unfortunately, we know that for every piece of

First Class Mail that disappears, there has to be three pieces of Standard Mail to make up for the lost revenue. To think that revenues and mail volumes will grow substantially in the short term would be unrealistic. So the process of rightsizing must happen in a much quicker manner, meaning the USPS should be allowed to manage its business without being encumbered by outside influences.

5. Do you think that the Postal Service is doing everything it can within its existing legislative authority to cut costs?

The USPS has been very aggressive with its cost cutting over the last few years, but only recently has it really focused on reducing employee levels through more than attrition. In the last few months it has attempted to do more in that regard, as well as with the closing and consolidation of postal facilities. More is needed, and as mentioned in my answer to Question 4, the Postal Service needs to be allowed to manage that process without opposition from local communities and Congressional representatives as long as it complies with the required process.

The USPS could probably also do more internal cost management and reduction by making changes to its cultural way of doing business (e.g., buying and selling homes as it relocates employees around the country numerous times).

6. You testified that your company and the printing industry work together with the Postal Service to try to maintain the lowest combined costs for mailers, from mailpiece design to mailbox delivery. With this principle in mind, what additional activities can be performed more efficiently by the mailing industry, and which should remain with the Postal Service?

The USPS is a delivery company. It has the infrastructure to manage daily delivery to every household. In today's environment, that is probably the only activity that would not be in play for Quad/Graphics. During the last 25 years, Quad/Graphics and the mailing industry have continued to create more efficient mail processing and delivery through worksharing efforts with the Postal Service. From presorting and barcoding to containerization and dropshipping of mail,

we continue to prepare mail in a way so that it can bypass much postal processing by the USPS that would otherwise be needed.

The USPS still has a need to automate more of its process, but given the financial challenges that it currently faces, it may not be possible in the near term for the Postal Service to purchase the necessary equipment. Instead, there may be an opportunity for the USPS to provide additional incentives to the mailing industry to expand the utilization of the cost-effective technologies and processes that are already in place. As long as the end result is a reduction in cost for the USPS and no net increase in cost for Quad/Graphics and our clients, all opportunities should be considered.

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