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**Presentation by**

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Before the Postal Regulatory Commission**

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Good morning Commissioner Goldway and Commissioners of the Postal Regulatory Commission. I was pleased to be invited to contribute comments on the larger challenges facing the Postal Service today as you discuss the Postal Service's Annual Compliance Plan.

I believe that the Commission is wise to take a broad, multi-year perspective on the challenges facing the Postal Service at the same time that you evaluate this specific year's compliance, as required under the Postal Accountability and Enhancement Act of 2006 (hereafter, PAEA). Taking a long view is an important way to gain a balanced perspective. What such balance yields, in the end, is the recognition that **both** cost reduction and revenue enhancement will be necessary to guarantee the long-term viability of the institution.

Focusing on the revenue side is becoming more important than ever. With the financial crisis of 2008-09, severe, unprecedented volume decline has

dramatically impacted postal revenues. As you know, this led Congress in 2009 to recalibrate and to adjust the timing of the requirements in PAEA obligating the Postal Service to pay retiree health benefits. Every indication at this time suggests that similar financial pressures will face the Postal Service again this year. First quarter financial results, just released by the USPS, showed another loss during the quarter that is normally expected to be the strongest. The USPS official forecast is for continued volume decline. In exceptional times like these, there is value in considering what might be done to enhance the broader context as well as to police the actions of the past year.

My goal is to contribute to your work this morning by expanding on testimony that I provided to the House Oversight Committee on November 5<sup>th</sup>. In other words, my focus concerns the revenue side of the financial stress that is facing the postal service today. Madame Chairman, you are of course familiar with this topic and this Congressional hearing as you testified yourself and reviewed a number of ways in which the Commission is seeking to work with the USPS to use the powers granted under PAEA that seek “to create a new framework for a self sustaining Postal Service that was capable of competing in the 21<sup>st</sup> Century Marketplace.”<sup>1</sup>

Few would say with certainty that they can forecast the market demands of the post crisis economy. How will future marketers choose to allocate scarce resources? How fast will electronic services replace First Class Mail transactions? But without fine tuning the answer to these questions, there is a fair question today of whether the law and the regulatory framework that has been established are currently leading to the creation of such a “self- sustaining Postal Service.”

The Postmaster General and his leadership team have been far more successful at cutting costs while sustaining service and customer satisfaction than

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<sup>1</sup> Page 1, Testimony of Chairman Ruth Y. Goldway before the U.S. House of Representatives Committee on Oversight and Governmental Reform Subcommittee on Federal Workforce, Postal Service and District of Columbia, November 5<sup>th</sup>, 2009, PRC.gov, testimony.

anyone would have thought was possible at the time that the USPS published its Transformation Plan in 2002. But they know this is not enough.

The imperative of growing revenue has been more challenging. Since the implementation of the new regulatory framework provided by PAEA has been accompanied by crushing economic problems for the economy as a whole, it's difficult to be clear about causes or to anticipate the success of revenue producing efforts after recovery.

Nonetheless, in summary, my comments make three points:

- The law and regulatory process is the sum total of the interaction of the regulator, the USPS with its officially sanctioned monopoly and the participants in the regulatory process (e.g. mailers and competitors). *The public record is clear that the Commission takes its responsibility to “**call balls and strikes**” seriously. But my question is: it will not also be important to the universal service mission of the postal service, in light of the financial crisis, for the PRC and the USPS to work with Congress and the Administration to “**widen the strike zone**”?*
- Second, on November 5<sup>th</sup> Madame Chairman, both you and Robert Bernstock, USPS President of Mailing and Shipping Services, made a number of suggestions about how the innovation process that must create new value for postal customers could be supported through the regulatory process. *As you consider matters of compliance, should not the Commission also join with the Postal Service to make the **regulatory process more innovative** to support revenue growth?*
- And finally, I made the recommendation on November 5<sup>th</sup> that the USPS has an opportunity to use the provisions sanctioned by PAEA (in section 1004) that encourage the use of **public private partnerships**. Here I raise a number of public policy questions that should no doubt receive attention if this vehicle were to become a dependable conveyance for creating new postal revenue. These include: Can the regulatory process that would govern such partnerships be clarified in advance? Should the Commission and the USPS not collaborate to make clear what each party – public and private – might expect? What postal revenue would be permitted?

The goal in the end should be for the Commission and the USPS to have created a framework in which the creativity of postal employees and the private sector can be encouraged. I found that often the employees of the USPS have the best ideas and have in fact been nurturing innovative concepts for some time. And,

the creative potential of the private sector should also be unlocked before its too late so that entrepreneurs come to the government saying “I have an app for that and I want to become a partner.”

## **Introduction and Background**

In assessing the capacity of the Postal Service to fulfill its mission of providing universal services to the American people, it's important to recognize that however the regulatory process works, it must support a flexible, competitive enterprise that can create new value for customers. There is abundant evidence that the monopoly is no longer sufficient to guarantee that customers will use postal services as opposed to the many other communications choices that they have available to them. Hence, the regulatory process may have to balance the needs of the Service and mailers and consumers with an emerging market reality that unless the mail is continuously reinvented to make it relevant to changing customer requirements, the Service will not be able to support itself.

In judging whether the interaction between the Commission and the USPS is working to that end you should ask:

- Are the Regulatory Commission's rules confining in a way that minimizes the capacity of the USPS to fulfill the spirit of PAEA's encouragement of revenue growth?

And second, if an objective view would find that the Commission's rules *are* confining but that this is required by PAEA, then you must ask,

- Are the legal constraints that PAEA placed on the Postal Service in 2006 now likely, in this post financial crisis market, to make it difficult for the postal service to create value for its customers?

To summarize my experience in addressing these questions, I have had the opportunity to work on strategic issues facing the USPS for some time. I formerly served as Vice President for Strategic Planning of the USPS and chief of staff for Postmaster General William Henderson. I also served under Marvin Runyon who brought me into the USPS in 1993 as Vice President for Technology Applications.

Since 2001 when I returned to consulting I have had the opportunity to see the USPS from many perspectives. I have worked for the President's Commission on the USPS, the Postal Service, and the Office of Inspector General of the USPS, the National Association of Letter Carriers, mailers, trade associations and technology suppliers. From this I have gained a multi-perspective viewpoint on the Service's problems.

I recognize that there has been considerable controversy for some time over the best way for the Commission to guide the USPS. One of your predecessors felt particularly strongly about what was proper for the USPS in seeking to develop new sources of revenue. Chairman Edward Gleeman once testified,

- "As for the Postal Service, it is at a crossroads with no signpost. As it did 25 years ago, Congress should provide direction. A major public policy question needs to be answered. And, unless Congress acts, I fear by default it will be answered by postal service managers. The question is both simple and complicated. It is this. What do we want? And what can we reasonably expect from our postal service? Do we want the Postal Service to limit its focus to its historical mission, the reliable, prompt delivery of hard copy mail? Or do we want it to attempt to compete in other fields heretofore foreign to it?"<sup>2</sup>

And I recognize that this controversy continues even today. Chairman Gleiman argued in 1995 that the postal service should not be permitted to engage in new services that were unrelated to the prompt, reliable delivery of hard copy mail at the very time that the marketplace was redefining what it valued and the Internet exploded.

Today, the Commission's January 14 ruling on non-postal services, implementing its responsibilities under PAEA does not sound very different.

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<sup>2</sup> Mr. Edward Gleiman, Chairman of the Postal Rate Commission, Hearings before the Subcommittee on the Postal Service, Committee on Government Reform and Oversight. U.S. House of Representatives 104<sup>th</sup> Congress at 83. (1995). As quoted in Reisner, Robert A. F., Lawrence G. Buc, James Pierce Myers, *The Postal Accountability and Enhancement Act, Some Consequences*, Chapter 17 Competition and Regulation in the Delivery Sector, Ed. Michael Crew and Paul Kleindorfer, CRR 2008.

- “The Commission finds the intent of Section 404(e) is to concentrate the Postal Service’s focus on its core responsibilities and away from non-postal services that are not justified by a public need which can not be met by the private sector.”<sup>3</sup>

By 2010 there is a law and there are specific criteria that are used to limit USPS action: is there a public need? Is the need being met by the private sector? As you know, this is a very high bar. What you must ask today is how should the public “need” be defined? Would you define need the same way if you shift the perspective from products and markets to the enterprise as a whole? What if the question were, could the USPS survive if it is not allowed to innovate to create new services that meet customer needs?

### **What is to be done?**

Three areas offer potential that may warrant future examination: creating an innovative regulatory framework, encouraging innovation and experimental design and clarifying, and thereby encouraging the oversight that might govern public-private partnership (PAEA, Section 1004).

### **1. Regulatory Innovation**

The long-term viability of the Postal Service will be shaped by the degree of innovation and creativity that the USPS is able to bring to the marketplace. Given the law, this in turn may be determined in significant part by the capacity of the regulatory process to facilitate and permit innovation.

In your testimony of November 5<sup>th</sup>, Madame Chairman, you note that there has been extensive use of the NSA contract mechanism but only limited use of experimental filings. This is cited to show that while there are some provisions of the law under which there has been a great deal of new activity, there are others that have not yet been employed.

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<sup>3</sup> Page 5, Order Number 392, Phase II Review of Non-Postal Services Under the Postal Accountability and Enhancement Act Docket MC2008-1.

But I am not sure that it may be concluded that because there have been few experimental filings that there is no experimentation taking place. What might be considered in the future is analyzing the role that experimental filings are playing in comparison with other vehicles for testing new services.

- Is this a true measure of the extent of innovation? That is, are there other mechanisms that are less cumbersome? Are these being used in preference to the PAEA?
- And if there should be more experimental filings taking place, what might be done to encourage the number of such proposals?
- Is it possible to approve in advance within a band of acceptable practice? Is it possible to create joint agreements in which parties are held harmless to unsuccessful efforts?

In the private sector, the companies that have been successful in introducing new services have often built on unsuccessful first attempts. FedEx and UPS have some famous examples that demonstrate the value of experimentation. Given the importance that new services could have for the Postal Service, can the regulator agree in advance that experimentation is valuable?

In your testimony of November 5<sup>th</sup> Madame Chairman, you state

- “The Postal Service yet may find the spark of innovation to create viable new classes of mail and other new products that are consistent with its mission as envisioned by the PAEA. The Commission looks forward to reviewing new proposals from the Postal Service for experimental products or pricing initiatives that may provide new sustainable sources of revenue for the future.”<sup>4</sup>

Is this subject to goal setting and joint measures of success?

## **2. Experimental Design**

There is a second area where the Commission can facilitate and encourage the creativity of the customers and the USPS rather than being a force for perpetuating the declining status quo. This is one place where I believe you could

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<sup>4</sup> Page 10, Testimony of Chairman Ruth Y. Goldway, November 5, 2009 *ibid.*

be working publicly to collaborate with the USPS to create a positive, flexible regulatory environment.

I noted earlier that Mr. Bernstock's testimony contained some specific suggestions. He noted that competitors do not have every contract scrutinized by a regulator. Nor is every contract considered a new product. In spite of the diligence with which the Commission may conduct 15-day turnarounds, those days are of course important in a competitive marketplace. They give the competition the time to match and beat the offers made by the postal service. He suggested that there were other alternatives to full pricing freedoms. These include:

- "After the fact review of each contract by the regulator,"
- "Pre-approved thresholds or limits to protect against substantial pricing risks," and
- "Broader definitions of product so that each individual contract for the same or similar product does not require a before-the-fact review."<sup>5</sup>

As an outsider to conversations that you may already be having with the Postal Service, I do not want to presume to know the best formulation of alternative, innovative regulatory procedures and the current interaction between the Commission and the USPS. But this general topic of process improvement and regulatory reform is one that could offer significant benefits for the revenue side of the USPS.

Two years ago Commissioner Blair and I were involved in a forum in which European regulators described some of their innovations as implementation of PAEA was taking place. I came away from that discussion sponsored by Pitney Bowes with the firm belief that there was more that could be done here to bring new value to postal customers.

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<sup>5</sup> Page 5, Testimony of Robert F. Bernstock before the House Oversight Committee referred to above, November 5, 2009.

### **3. Encouragement of Public Private Partnerships**

As I testified on November 5<sup>th</sup> I have had the privilege of working on creating innovative products for the postal service for some time. More than a decade ago, when we were creating an Electronic Postmark and a Certificate Authority that could encourage digital signatures and ecommerce, there was a view that if the USPS were to do this at all, the Postal Service should be the service provider. Perhaps that was correct at that time. But the market has evolved. Some policy questions are settled. In other words, that was then, this is now.

The marketplace of the future will be no less interested in innovative postal services that are, for example, interconnected with the Internet. Recognizing that some of the services that will be critical to growing traditional hard copy mail volume are non-postal services the question for the future regulator will be how should such future service arrangements be structured? To make mail relevant such interconnections will have to be developed. But to engage in integrating multi-channel communications, a new vehicle will have to be found. Perhaps Section 1004 of PAEA that encourages public private partnership is such a concept.

But the fact that PAEA encourages partnership is not, I believe, enough to give confidence to private entrepreneurs or public managers. I would offer three questions that should be addressed:

- Can the regulatory process that would govern such partnerships be clarified in advance?

One question that public private partnerships raise is whether the public institution is granting a special favor to a private competitor? To some extent the dilemmas that are suggested here could be addressed through due process and disclosure. But if there were no rules or policies, it would be hard for the entrepreneur to know that their investment or intellectual property was protected.

Other policy questions might be: is there a need – a public need – for the service? Or, is the market already well served by the private sector? Clearly, the question of non-postal services enters the discussion at some point.

- Should the Commission and the USPS not collaborate to make clear what each party – public and private – might expect?

These are not new topics. There is a great deal of experience in other industries. A white paper that created some rules of good practice would go a long way toward showing both postal employees and private entrepreneurs how to take the first steps.

In the final analysis, there is no reason to believe that the definition of a postal service that was included in PAEA is a market-based definition. Mailers seeking to manage relationships with their customers do not think in terms of mailing services versus non-mailing services. Today's marketplace is multi-channel and even if the USPS is to be limited to paper based communications, would it not be more effective for postal customers for a new multichannel service to emerge? Would it not be good for mail?

- What postal revenue would be permitted?

Finally, the most interesting question of all: what revenue might be created with multi-channel, public-private partnerships? If the public's institution is taking action to create equity for the entrepreneur can it participate in the new value that is being created?

This is clearly a big topic and the vehicles that might be considered to enable the USPS and its employees to participate in the gain are the subjects of a rich discussion another time.

The Commission has recognized in the past that the Postal Service is at the heart of the economy performing transactions that enable commerce. Even at 170 billion pieces of mail (instead of 212 billion of a few years ago) it is still playing a central role in an industry of nearly 8 million workers. My comments today have concerned matters that are controversial – Are the rules too tight? Can the USPS survive? Is it being innovative enough? Whose fault is that? Reasonable people can disagree about causes and solutions. But in this time of economic stress should we not be not be tilting toward encouraging revenue growth? Should we not ask what ***might be done today to ensure that a strong Postal Service can support the U.S. economy's emergence from recession?***