

Subcommittee on Federal Workforce, U.S. Postal Service and the Census
U.S. House of Representatives' Committee on Oversight & Government Reform

Ahead of Postal Reform: Hearing From USPS Business Partners
April 10, 2013

Statement of Joy Franckowiak
on behalf of
Cox Target Media, Inc. and Valpak Direct Marketing Systems, Inc.

Chairman Farenthold, Ranking Member Lynch, and Members of the Subcommittee:

My name is Joy Franckowiak. I am Director of Postal Affairs and Distribution of Valpak Direct Marketing Systems, Inc., located in Largo, Florida. Valpak is part of Cox Target Media, Inc., which is part of Cox Enterprises, Inc. — a leading communications, media and automotive services company.

Thank you for this opportunity to testify. I have been with Valpak for more than 18 years. I also chair the Government Affairs Committee of the Association of Marketing Services Providers, and serve on its Board of Directors, but I am testifying today only for Valpak. (A summary of my job responsibilities and experience is appended to this statement.)

I. VALPAK

Valpak has been in business for over 45 years and is one of the largest direct mail companies in North America. We pioneered the concept of local cooperative mail in the United States several decades ago and we operate through franchises in nearly every state and across Canada. Our franchisees are local independent businesses, with employees who live and work in towns across America. They sell the advertising that drives significant economic activity for small business — the lifeblood of the American economy.

A few years ago, we opened a state-of-the-art \$220 million manufacturing center in St. Petersburg, Florida so that Valpak can deliver savings and value to about 40 million households each month. And, each year, the Postal Service delivers almost a half billion of our familiar blue envelopes containing some 20 billion money-saving offers throughout the country, exclusively using the Postal Service. Valpak helps American families save money, especially in tough economic times, and helps small businesses grow. Each year, we assist more than 54,000 advertisers in promoting their products and services.

Our company also has aggressively entered the digital space in the online and mobile coupon business. This will allow us to reach new customers with our products and continue to serve as a leader in our industry. Our digital strategies will continue to complement our printed product strategies.

Most mailers choose to use the mail as one of several available methods of advertising, shipping or publishing, but Valpak's actual product is the mail that we send.

That's why Valpak has for almost 20 years been one of the most active mailers before the Postal Regulatory Commission, and has been active on the Mailers Technical Advisory Committee ("MTAC"), and has worked as test sites for the Postal Service in evaluating new cost-saving measures.

That's why Valpak actively supported the Postal Service's move to increase efficiency by reducing the number of money-losing post offices,¹ as well as the Postal Service's network re-alignment.²

Valpak was also one of the first large mailers to support former Postmaster General Potter's announced need to move to five day delivery,³ and, along with the majority of Americans, still support it.

Although some other mailers may only care about low rates in the short term, Valpak is committed to the long term financial health of the Postal Service. And we submit that must be Congress' focus as well.

II. USPS OPERATIONS

Because we mail about 10 million Valpak envelopes a week, we rely heavily on timely delivery across the country. We incur the cost to ship our envelopes to Postal Service processing plants across the country — this practice is known as drop shipping. We send out approximately 160 trucks each month to more than 150 Postal Service Sectional Center Facilities. The Postal Service rarely gets credit for what it is doing right, but its timely delivery of drop shipped Standard Mail has been outstanding. Currently the Postal Service delivers over 97 percent of our product on-time.

¹ Valpak submitted an [Initial Brief](#) and a [Reply Brief](#) in support of the Postal Service's plans in Commission Docket No. N2011-1.

² Valpak submitted an [Initial Brief](#) and a [Reply Brief](#) in support of the Postal Service's plans in Commission Docket No. N2012-1.

³ Valpak also submitted an [Initial Brief](#) and a [Reply Brief](#) in support of the Postal Service's original 5-day proposal in Commission Docket No. N2010-1.

I also want to report on the progress being made regarding the 150-plus postal facilities that have been identified for closing as an essential cost-cutting strategy.⁴ Almost half of these planned closings affect facilities where Valpak enters its mail. But the Postal Service has done an excellent job in working with mailers to minimize confusion and delay during this transition. The Postal Service has used many methods to advise mailers which facilities would be affected, where mail should be entered, and when the changes would go into effect. Mailers have worked with the Postal Service in adjusting to the new system. We have had some extra work to do, but have had no significant problems through this transition.

The Postal Service is committed to ensuring that no mailer is caught off guard by its improvements. To increase communication, last year Postal Service Chief Operating Officer Megan Brennan reinstated area-wide meetings with mailers. The Postal Service operates through seven Areas, and one-day meetings are held in each Area to ensure that mailers are fully advised of upcoming developments. I serve as co-chair of the Southern Area Focus Group, and at our last meeting in Dallas, about 100 mailers received briefings by national staff and area officers. This outreach to the different areas helps reach mailers especially small to midsize mailers who cannot spend several days at the annual National Postal Forum, which is also an important outreach tool — despite some unfair criticism which it received recently.

To improve service and decrease processing costs, the Postal Service has vastly increased use of technology. We were one of the Postal Service's first customers to implement the Full Service Intelligent Mail barcode ("IMb") for outbound mail. The Postal Service, as well as mailers, uses the IMb to track mail through its system to the point of delivery.

Now, it is moving to what is called Seamless Acceptance, which would eliminate clerks at mailer facilities' Detached Mail Units and reduce many other acceptance costs, substituting computer analysis of the mail. Valpak was the first mailer to test E-Drop Ship and Seamless Acceptance, which is now used in about five postal plants, and soon both will be rolled out across the Postal Service processing network.

The nature of our business means that we watch the Postal Service and its issues very closely. Most mailers had to go through a painful downsizing program a few years ago. We believe that Postmaster General Pat Donahoe has done a remarkable job of right-sizing his business to adjust to plummeting mail volume. We urge Congress to allow him to do what it needs to do to cut costs and survive financially.

Congress may write the laws, but the mailers are footing the bill for every dollar of expense that Congress refuses to allow the Postal Service to cut. And Congress needs to remember that as prices increase, mailers enter less mail.

⁴ <http://about.usps.com/news/electronic-press-kits/our-future-network/welcome.htm>.

The Postal Service simply cannot afford to deliver mail six days a week without causing price increases. Congress may be able to force the Postal Service to keep Saturday delivery, but Congress cannot force mailers to mail.

Let me shift gears, and now I would like to highlight some key problems that we believe Congress needs to address as your craft revisions to the Postal Accountability and Enhancement Act (“PAEA”).

II. UNDERWATER PRODUCTS

It is a mystery to me why the Postal Service believes it can lose enormous amounts of money on products, as no business could ever operate that way. In fact, during the six years since PAEA was enacted, \$8.1 billion of the Postal Service’s \$9.0 billion in operating losses were caused by underwater products. Nevertheless, neither the Postal Service nor the Commission appears willing to follow the law.

Although most press accounts of Postal Service finances focus on the gross loss that includes Retiree Health Benefits Fund payments,⁵ just as important is the Postal Service’s operating loss, which is the focus of the following comments. Table 1 shows Postal Service operating revenue and operating expenses for FY 2007 through FY 2012, the years following enactment of PAEA in December 2006. The first row shows operating revenue, all of which is derived from mailers, except for a few minor items. The second row shows all operating expenses, excluding retiree health benefits. Payments for health insurance premiums for current retirees, which always have been recorded as operating expenses, are shown separately on row 4. The net profit or loss from operations is shown on row 5.

⁵ The need to reform the RHBF prefunding schedule is well-known. Although not the focus of this statement, any postal reform legislation must include some reasonable relief to the RHBF schedule.

Table 1
Postal Service Operating Revenue and Expenses
FY 2007 – FY 2012
(\$, millions)

| | FY '07 | FY '08 | FY '09 | FY '10 | FY '11 | FY '12 |
|--|---------------|---------------|---------------|---------------|----------------|----------------|
| 1. Operating Revenue | 74,778 | 74,932 | 68,090 | 67,052 | 65,711 | 65,223 |
| 2. Operating Expenses, Ex-Retiree Health Benefits | <u>70,021</u> | <u>70,331</u> | <u>68,440</u> | <u>67,679</u> | <u>68,193</u> | <u>67,235</u> |
| 3. Op. Profit (Loss) Before Retiree Health Benefits | 4,757 | 4,601 | (350) | (627) | (2,482) | (2,012) |
| 4. Health Benefits for Current Retirees | <u>1,726</u> | <u>1,807</u> | <u>1,990</u> | <u>2,247</u> | <u>2,441</u> | <u>2,629</u> |
| 5. Net Op. Profit (Loss), excluding RHBFB | 3,031 | 2,794 | (2,340) | (2,874) | (4,923) | (4,641) |
| 6. Funding of RHBFB | 8,358 | 5,600 | 1,400 | 5,500 | ----- | 11,100 |
| 7. Six-year net operating loss , excluding RHBFB | | | | | | 8,953 |
| 8. Six-year cost of RHBFB | | | | | | <u>31,958</u> |
| 9. Six-year total reported loss | | | | | | 40,911 |

In FY 2012, the Postal Service allowed there to be eight “underwater” products — where the revenues earned did not even cover these products’ “direct and indirect attributable costs.” Last year, on these eight products, the Postal Service lost nearly \$1.5 billion, *i.e.*, approximately 75 percent of the Postal Service’s total operating loss. *See* Table 2. Valpak has asked the Commission to remedy this ongoing, widespread problem repeatedly, most recently in comments in the annual compliance review for FY 2012.⁶

Only about 60 percent of Postal Service costs are attributed to products, so even a product which merely covers its attributable costs is not paying anything toward the overhead of the Postal Service. A product or a class that does not even cover its attributable costs presents an even more serious hemorrhage to Postal Service finances.

⁶ *See* Commission Docket No. ACR2012, Valpak’s [Initial Comments](#) and [Reply Comments](#).

Table 2
Loss-Generating Market Dominant Products
FY 2011-2012
(Exclusive of Special Services)

| Product | FY 2011 Deficit (million) | FY 2011 Coverage | FY 2012 Deficit (million) | FY 2012 Coverage |
|--|--------------------------------------|-----------------------------|--------------------------------------|-----------------------------|
| First-Class Parcels | — | — | \$10 | 98.4% |
| Inbound Int. Single-Piece First-Class Mail | \$36 | 79.0% | \$66 | 65.8% |
| Standard Mail Flats | \$652 | 79.3% | \$532 | 80.7% |
| Standard Mail NFM's and Parcels | \$117 | 84.8% | \$53 | 84.3% |
| Periodicals Within County | \$20 | 77.5% | \$29 | 69.7% |
| Periodicals Outside County | \$597 | 74.5% | \$649 | 71.8% |
| Single-Piece Parcel Post | \$89 | 89.2% | \$66 | 92.1% |
| Bound Printed Matter Parcels | \$5 | 98.4% | — | — |
| Media and Library Mail | \$99 | 77.0% | \$56 | 85.1% |
| Total | \$1,615 | | \$1,461 | |

Sources: FY 2011 ACR, Tables 1-4; FY 2012 ACR, Tables 1-2, 4-5.

A serious problem exists with **Standard Flats** — used by some catalog companies — which lost an amazing \$532 million last year, covering only 80.7 percent of its costs. The Postal Service could increase these prices significantly, but refuses to do so, as it prefers to overcharge other Standard mailers to subsidize the catalogers with which they compete. Just since PAEA, Postal Service pricing has forced other mailers to cross-subsidize these catalog mailers by a total of \$2.6 billion. The Commission repeatedly has found this pricing unlawful, but it has refused to use the power Congress gave it to order the Postal Service to make meaningful price increases for this money-losing product.

Table 3
Standard Mail Flats
Revenue, Costs and Contribution
FY 2008 – 2012
(millions)

| <u>Fiscal Year</u> | <u>Revenue</u> | <u>Attributable Cost</u> | <u>Contribution</u> | <u>Volume</u> |
|--------------------|----------------|--------------------------|---------------------|---------------|
| 2008 | \$3,663.7 | \$3,891.0 | -\$227.3 | 10,010.875 |
| 2009 | 2,866.0 | 3,488.3 | -622.3 | 7,793.511 |
| 2010 | 2,579.4 | 3,161.3 | -581.9 | 7,049.230 |
| 2011 | 2,491.1 | 3,142.9 | -651.8 | 6,783.186 |
| 2012 | <u>2,229.6</u> | <u>2,761.7</u> | <u>-532.1</u> | 5,939.635 |
| TOTAL | \$13,829.8 | \$16,445.2 | -\$2,615.4 | |

Source: CRA for each respective year.

A different problem exists with the **Periodicals** class, which lost \$670 million last year, and Periodicals' mailers covered only 72.1 percent of their costs. However, there the entire fault lies with the Commission, which in its Annual Compliance Determination recently refused to find that even this enormous loss constituted "noncompliance" with PAEA — despite Valpak's and the Postal Service's requests that it clearly rule on the scope of its powers to remedy this problem. Congress required that each class must cover its cost, but the Commission reasoned that since the problem of underwater Periodicals has existed for so long (constantly losing money for the Postal Service over the past 16 years — totaling \$5.6 billion), Congress must have wanted it to be that way.

Table 4
Periodicals Class
Revenue, Cost, Coverage, and Cross-Subsidies
FY 1997 — 2012

| | (1) | (2) | (3) | (4) |
|-------------------|-----------------|-----------------|---------------|--------------------|
| PRC CRA | Revenue | Costs | Cover- age | Revenue – Costs |
| Year | (\$, mill.) | (\$, mill.) | | (\$, mill.) |
| Under PAEA | | | | |
| 2012 | 1,731.5 | 2,401.6 | 72.10% | -670.1 |
| 2011 | 1,821.1 | 2,430.0 | 74.94% | -608.9 |
| 2010 | 1,878.8 | 2,489.8 | 75.46% | -611.0 |
| 2009 | 2,038.0 | 2,680.0 | 76.04% | -642.0 |
| 2008 | 2,294.9 | 2,732.1 | 84.00% | -437.2 |
| 2007 | 2,187.9 | 2,635.6 | 83.01% | -447.7 |
| Subtotal | 11,952.2 | 15,369.1 | 77.77% | -3,416.9 |
| Under PRA | | | | |
| 2006 | 2,124.8 | 2,487.6 | 85.42% | -362.8 |
| 2005 | 2,068.9 | 2,431.6 | 85.08% | -362.7 |
| 2004 | 2,100.0 | 2,323.3 | 90.39% | -223.3 |
| 2003 | 2,139.6 | 2,196.2 | 97.42% | -56.6 |
| 2002 | 2,066.9 | 2,280.4 | 90.64% | -213.5 |
| 2001 | 2,106.9 | 2,367.1 | 89.01% | -260.2 |
| 2000 | 2,076.3 | 2,354.8 | 88.17% | -278.5 |
| 1999 | 2,017.7 | 2,213.1 | 91.17% | -195.4 |
| 1998 | 1,972.8 | 2,129.0 | 92.66% | -156.2 |
| 1997 | 1,964.6 | 2,038.5 | 96.37% | -73.9 |
| Subtotal | 20,638.5 | 22,821.6 | 90.43% | -2,183.1 |
| | ----- | ----- | ----- | ----- |
| TOTAL | 32,590.7 | 38,190.7 | 85.34% | -5,600.0 |

A step in the right direction was the Issa/Ross bill (H.R. 2309) reported out of this Committee in the last Congress. It would have done much to remedy underwater products as well as many of the other problems facing the Postal Service, and we urge that these remedial provisions, at a minimum, be included in the new bill.

When some products pay none of the overhead, the other products must pay all of it. The product that has the highest burden imposed on it happens to be the one used by Valpak — High Density/Saturation Letter Mail. That Standard Mail product has a coverage of 221 percent, and receives significant annual price increases even though it is the only Standard Mail product whose costs have actually decreased over the past six years. Some of the burden of these price increases have been offset by various incentive programs, but Valpak would much prefer that the general tariff rates be kept low, rather than needing to jump through hoops to qualify for special temporary sales. Postage rates are extremely important to our franchisees and every postal increases has an adverse impact on the volume they mail.

III. NEW PRODUCTS

The Postal Service also has had problems with some of its new product offerings. It began a market test for Every Door Direct Mail-Retail (“EDDM”), which is locally-entered, saturation, unaddressed mail. The Commission found that EDDM violated PAEA, in that it exceeded the Congressionally-imposed \$50 million annual cap on market tests. But the Commission but ignored the violation since the test had ended.⁷

Also, the Postal Service says that it is committed to automation and transparency of mail, but EDDM is a manually-handled product which provides no transparency whatsoever.

Lastly, while other mail must be addressed, the Postal Service exempts EDDM from this requirement so it can directly compete for this business with other mail service providers. While some EDDM mail may be new volume, the Postal Service cannot be successful if it uses marketing strategies which cannibalize business from existing mailers. Even the Postal Service’s Inspector General could not tell whether any or all of EDDM was coming from businesses already using mail service providers.⁸

IV. NEGOTIATED SERVICE AGREEMENTS

The Postal Service believes that Congress wants it to enter into Market Dominant Negotiated Service Agreements, or NSAs. Its track record with such agreements has been

⁷ FY 2012 Annual Compliance Determination, p. 152.

⁸ USPS OIG, Audit Report: Every Door Direct Mail-Retail (May 7, 2012), https://www.uspsoig.gov/foia_files/ms-ar-12-004.pdf.

terrible. It has lost millions of dollars, yet it continues to pursue NSAs. The profitable ones barely make a dent, while the unprofitable constitute yet another serious drain on Postal Service finances.

Table 5
Summary of Market Dominant NSAs
Net Effect on Postal Service Contribution
(\$ Thousands)

| | 2009 | 2010 | 2011 | 2012 | Total |
|-----------------|-----------------|-----------|-------------|----------------|-----------------|
| Bookspan | | | | | 20 |
| Lifeline | 25 | 104 | 0 | | 129 |
| Bradford Group | 93 | (72) | (37) | | (16) |
| Bank of America | (23,514) | | | | (23,514) |
| Discover | | | | (4,338) | (4,338) |
| Valassis | | | | | |
| Total | (23,396) | 32 | (37) | (4,338) | (27,719) |

A recent NSA with one mailer is now on appeal to the U.S. Court of Appeals for the D.C. Circuit, and Valpak has joined with the Newspaper Association of America and the National Newspaper Association in the appeal. That NSA provides special discounts to a large national mailer to enable it to enter into new markets to directly compete with other, already established advertisers. This marketplace is already highly competitive, and we had hoped that the Commission would stand in its place as a regulator of the Postal Service and protector of the marketplace. We are disappointed that we are having to rely on the courts to play that role.

Another NSA with one credit card mailer (Discover) lost \$4.3 million in its first year, and neither the Postal Service nor the Commission has been willing to use the authority they have under the law to terminate that agreement. The Commission's recent Annual Compliance Determination found that the NSA with Discover violated the statutory requirement that it not result in a loss to the Postal Service.⁹ Nevertheless, the Commission took no action, merely suggesting to the Postal Service that, if the second year also results in a loss, the Postal Service should re-evaluate continuing the NSA.

⁹ See FY 2012 ACD, p. 158.

We have proposed specific statutory language to help stem losses from these ill-conceived NSAs.¹⁰

First, subsection (A)(i) currently provides that an NSA “improve the net financial position of the Postal Service,” and the proposed amendment clarifies that this criterion will be determined based on the Commission-approved methodology. The Postal Service always claims greater financial improvement of NSAs based on its own methodology. The Commission’s methodology is more conservative and likely is more accurate, yet the Commission has approved NSAs which were projected to result in a net financial loss using its own methodology. Our proposed amendment would clarify how to calculate financial improvement.

Second, our proposed subsection 3622(c)(10)(C) adds two additional criteria.

New subsection (C)(i) would require a Commission finding that it would be “impracticable to offer” a niche classification that would be made available more broadly, such as part of the general tariff schedule. There was a similar requirement under Commission

¹⁰ 39 U.S.C. § 3622(c)(10) (New language is shown as underlined; deletions are shown as strikethrough.)

(10) the desirability of special classifications for both postal users and the Postal Service in accordance with the policies of this title including agreements between the Postal Service and postal users, when available on public and reasonable terms to similarly situated mailers, that—

(A) either—

(i) improve the net financial position of the Postal Service through reducing Postal Service costs or increasing the overall contribution to the institutional costs of the Postal Service, based on methodology approved by the Commission; or

(ii) enhance the performance of mail preparation, processing, transportation, or other functions; ~~and~~

(B) do not cause unreasonable harm to the marketplace; ~~and~~

(C) no agreement with one mailer or a group of mailers shall be approved unless the Commission —

(i) makes a finding that it would be impracticable to make such a classification available to all mailers, and

(ii) identifies the specific criteria by which mail users would be deemed “similarly situated mailers” entitled to receive a functionally equivalent agreement.

regulations for NSAs prior to PAEA.¹¹ Niche classifications address some of the systemic problems identified with NSAs, and eliminate the inherent problem of preferences and discrimination (39 U.S.C. § 403(c)) among mailers.

New subsection (C)(ii) would require the Commission to determine which mailers are similarly situated to a mailer in an NSA so that they will be entitled to their own NSA.

CONCLUSION

The Commission has taken a hands off approach to postal pricing on the theory that Congress gave the Postal Service broad “pricing flexibility,” and wanted the Commission to use only “light handed regulation.” We cannot believe this is what Congress wanted. If the Commission ignores the below-cost pricing and cross-subsidization of many products, abusively high prices for other products, losses incurred by NSAs, and violation of limits on Market Tests, then exactly how does the Commission protect the public from the Postal Service misusing its monopoly pricing power over Market Dominant products?

Looking at the larger picture, the Postal Service is at the heart of a \$1.3 trillion industry which employs 8.4 million people. It appears clear that the Postal Service needs greater flexibility to cut costs, but greater regulation by the Commission over the Postal Service’s pricing strategies. Both can be accomplished by this Subcommittee as it considers amendments to PAEA.

Thank you.

¹¹ Former regulation 39 C.F.R. § 3001.195(a)(1) required: “A written justification for requesting a Negotiated Service Agreement classification as opposed to a more generally applicable form of classification.”

Joy Franckowiak
Director, Postal Affairs & Distribution
Cox Target Media/Valpak

Joy Franckowiak, Director, Postal Affairs & Distribution for Cox Target Media/Valpak, headquartered in Largo Florida is responsible for the day-to-day operations of the department as well as its strategic planning.

In December 2010, Joy became the lead on federal activities related to Postal and Transportation. Joy leads Valpak efforts with the Postal Regulatory Commission (“PRC”) and with Postal Headquarters, and is active with the Mailers Technical Advisory Committee (“MTAC”).

Her career with Valpak began in 1994, and she has held a variety of operational and management positions over her almost 19-year career with Valpak.

Joy also sits on the Board of Directors for the Association of Marketing Service Providers (“AMSP”) where she also is chair of its Government Affairs Committee. Joy is also a member of Women in Logistics and Delivery Services (“WILDS”).

Committee on Oversight and Government Reform
Witness Disclosure Requirement – “Truth in Testimony”
Required by House Rule XI, Clause 2(g)(5)

Name: Joy Franckowiak

1. Please list any federal grants or contracts (including subgrants or subcontracts) you have received since October 1, 2010. Include the source and amount of each grant or contract.

N/A

2. Please list any entity you are testifying on behalf of and briefly describe your relationship with these entities.

Cox Enterprises

Cox Target Media

Valpak Direct Marketing Systems, Inc.

Employee of Cox Target Media/Valpak Direct Marketing Systems, Inc.

3. Please list any federal grants or contracts (including subgrants or subcontracts) received since October 1, 2010, by the entity(ies) you listed above. Include the source and amount of each grant or contract.

N/A

I certify that the above information is true and correct.

Signature:



Date:

4/5/13