

ALASKA BYPASS MAIL DELIVERY: A BROKEN SYSTEM

HEARING

BEFORE THE
SUBCOMMITTEE ON FEDERAL WORKFORCE,
US POSTAL SERVICE AND THE CENSUS
OF THE
COMMITTEE ON OVERSIGHT
AND GOVERNMENT REFORM
HOUSE OF REPRESENTATIVES
ONE HUNDRED THIRTEENTH CONGRESS

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ALASKA BYPASS MAIL DELIVERY: A BROKEN SYSTEM

Tuesday, March 4, 2014

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON FEDERAL WORKFORCE, U.S. POSTAL
SERVICE, AND THE CENSUS,
COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM,
Washington, D.C.

The subcommittee met, pursuant to call, at 1:33 p.m., in Room 2154, Rayburn House Office Building, Hon. Blake Farenthold [chairman of the subcommittee] presiding.

Present: Representatives Farenthold, Collins, Issa, Clay, and Cummings.

Staff Present: Ali Ahmad, Professional Staff Member; Melissa Beaumont, Staff Assistant; Will L. Boyington, Deputy Press Secretary; Molly Boyd, Deputy General Counsel and Parliamentarian; Lawrence J. Brady, Staff Director; Sharon Casey, Senior Assistant Clerk; John Cuaderes, Deputy Staff Director; Adam P. Fromm, Director of Member Services and Committee Operations; Linda Good, Chief Clerk; Tyler Grimm, Senior Professional Staff Member; Mark D. Marin, Deputy Staff Director for Oversight; Ashok M. Pinto, Chief Counsel, Investigations; Jeffrey Post, Senior Professional Staff Member; Jessica Seale, Digital Director; Peter Warren, Legislative Policy Director; Rebecca Watkins, Communications Director; Eric Cho, Detailee; Kevin Corbin, Minority Professional Staff Member; Devon Hill, Minority Research Assistant; Julia Krieger, Minority New Media Press Secretary; Lucinda Lessley, Minority Policy Director; and Mark Stephenson, Minority Director of Legislation.

Mr. FARENTHOLD. The committee will come to order.

I would like to begin this hearing by stating the Oversight Committee's mission statement, as we do at every hearing. We exist to secure two fundamental principles. First, Americans have a right to know that the money Washington takes from them is being 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 the 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 start today by recognizing myself for a short opening statement. Today we are here to discuss the Alaska Bypass mail deliv-

ery. Our goal is to see if the current Bypass system is really the most cost-effective way for the Postal Service to subsidize the cost of packages for delivery to rural and outlying areas in the State of Alaska and talk about whether it is also the most economical way for the Alaskan people. We will also discuss a number of potential reform options for the Bypass system that could provide the cost-effectiveness that the Postal Service needs in able for a greater benefit to be able to be passed along to rural Alaskans.

The Bypass system was first designed in 1972 as a way to save the Postal Service money and improve service to isolated villages throughout the State of Alaska. Under the system, instead of large parcel orders being processed through the normal Postal Service infrastructure, the entire process is run and managed by private air carriers throughout the State.

Over the last several decades, Bypass mail has evolved into the most widely used way to ship many foods and commodities to the rural areas of the State on large several-hundred-pound pallets that are shrink wrapped. As a result, Bypass mail doesn't look at all like the mail we have in the other 49 States.

Under the current system, Bypass orders must be at least 1,000 pounds. This differs greatly from the Postal Service policy outside of Alaska which prohibits parcel post weighing more than just 70 pounds. Once the 1,000 Bypass order is placed, it is fulfilled at warehouses in Anchorage or Fairbanks and completed orders are grouped together on any number of pallets. From there the pallets are handed off directly to private air carriers who are then responsible for the transportation and final delivery of the shipment.

The air carriers are paid for their service based on rates set by the Department of Transportation. It is one of the last remaining vestiges of the government setting rates for airlines. The Postal Service has no control over these rates and no power to contract with more efficient service providers. It may only pay the applicable rate to each air carrier that has met certain statutory qualifications.

With little power to control costs, the Bypass Program only covers about 30 percent of its cost. In the last fiscal year, the Postal Service lost more than \$70 million operating the Bypass system. In D.C.-speak that may not sound like a lot of money, but you multiply it over the 40 years of the program, we are talking close to \$3 billion.

Today's Bypass mail system is tightly governed by lengthy statutes that create significant barriers for entry for new air carriers and deliberately discourage competition. The ostensible goal of this regulation is to allow air carriers to feel secure in markets and allowing them to feel comfortable in purchasing larger, more efficient aircraft without fear of being outcompeted by new, more efficient competitors.

However, a November 2011 report by the IG, inspector general of the Postal Service, has cast doubt on whether the Bypass Program is operating ideally for the Postal Service or for the rural Alaskan. Specifically, the IG audit concluded that the current system subsidizes the Alaskan aviation industry, is made up of shipments that would normally be nonmailable elsewhere in the Nation, and appears to fail at reducing the cost of goods for rural

Alaska, with the savings to the program largely diverted to a wide variety of other commercial interests within the State.

Today we will hear testimony from representatives of many of the key stakeholders in the current system, the Postal Service, the Department of Transportation, and two representatives of the Alaska aviation industry. But first we will hear from some of the elected representatives here in Washington from Alaska. I thank the witnesses and look forward to a spirited discussion on how we can make this important program better.

I will now recognize the distinguished ranking member, I guess of the full committee, Mr. Cummings.

Mr. CUMMINGS. Thank you very much, Mr. Chairman.

The Alaska Bypass Program is one of the most complicated systems in the United States Postal Service and is unfamiliar to those who have never lived or traveled to Alaska. The system was established in response to a unique local circumstance and needs.

Unlike other Postal Service programs, the Bypass Program is just not only to deliver packages and freight, but also to subsidize passenger air service to remote locations in Alaska. It is proper for us to examine whether the Bypass Program is the most efficient way of moving packages in Alaska and whether it remains the right way to support faster air service there.

In 2011 the Postal Service inspector general issued a white paper finding that the cost of the Alaska Bypass Program exceeded the rates paid by shippers by tens of millions of dollars every year, resulting in significant annual losses to the Postal Service. The inspector general offered recommendations to reduce the costs of and increase the revenues generated by the Bypass Program to make the Postal Service responsibilities in Alaska more reasonable and consistent with its current role to provide universal service, as it does in every other State.

Last month the committee voted to approve H.R. 4011, the Alaska Bypass Fair Competition Act. During our consideration of this legislation Chairman Issa stated that the measure would encourage greater competition and bring savings to the Postal Service and rural Alaskans. However, the committee considered H.R. 4011 without first holding hearings or hearing from Alaska residents.

Before the vote last month, Congressman Don Young of Alaska wrote to the committee in opposition to this legislation. He wrote that, "The passage of H.R. 4011 will undermine successes accomplished," in the Rural Service Improvement Act of 2002. He also wrote, "The market pressures would invite the operations of smaller, less efficient carriers and necessitate multiple stops. This will increase the operating costs of the USPS, and these costs will ultimately be passed along to consumers and taxpayers."

I am pleased that we are convening a hearing today to examine the many complexities of the Bypass Program. I am also pleased that we now have the opportunity to hear from Senator Begich, as well as Congressman Young, since they represent the people who would be directly affected by any legislation reported by this committee.

With that, Mr. Chairman, I yield back and look forward to the testimony.

Mr. FARENTHOLD. Thank you very much.

And I believe the Chairman of the full committee, the gentleman from California, Mr. Issa, has an opening statement as well.

Mr. ISSA. Thank you, Mr. Chairman. And I want to associate myself with the ranking member's statement. This committee does have an obligation to protect the ratepayers of the post office, particularly in light of their year-over-year losses.

Additionally, I side with the ranking member in saying that the earlier bill moved last month or 2 weeks ago was in fact moved specifically without a hearing. One of the reasons for that was that when the law was created, it was moved without a hearing and it was clearly anticompetitive.

Notwithstanding that, Alaskan Bypass Mail is, in fact, a complex system, carefully constructed as a program designed purposely to use postal taxpayers—it is designed for the purpose of having postal ratepayers' funds subsidize Alaska's aviation industry. Last year alone, that subsidy was \$76 million.

I make no attempt to minimize the fact that the situation in Alaska is different than the lower 48. Additionally, the situation in Alaska really does beg the question of, are there places in which universal service is required and promised and not available by road? The answer, of course, is yes.

There is no question, though, that the bulk ordering system in Alaska, if it were simply done exactly the same as the lower 48, would still lose money, but it would lose very little money. If the parcel post rate were applied, the losses to the post office would be less. That is not to say that I want to end Bypass mail. Just the opposite. The bill that we are going to be considering in a markup next week is designed to bring Bypass mail to a 50 percent self-sufficiency with a 50 percent subsidy.

Now, going from 30 to 50 percent shouldn't seem like a lofty goal, nor does it mean that over the coming weeks, months, or years we are going to fix a system that should be funded by appropriations, should be funded by the FAA, should be funded by the transportation bill, but in fact is funded on the backs of ratepayers. The postal inspector general, though, deserves to have his recommendations considered and efficiencies found.

I will give you an example of why Alaskans should be concerned. If I were to go, as I did, to Anchorage and attempt to buy a bag of potato chips, the cost of a given bag of potato chips would be \$4.29 in Anchorage, while in Bethel, some 400 miles away, a single plane trip, which I took, the price would go to \$9.99, meaning more than double, more than \$5.

The fact is the shipping costs under Bypass mail for that trip is 35 cents. Alaskans need to understand that the prices they pay in Bethel or on remote islands often have more to do with other parts of distribution and profiteering by people in that system. The difference between 35 cents and \$1 in that bag of chips, if passed on proportionately, would take that \$4.29 bag that already goes to \$10 and would take it to \$10.70. I am not asking Alaskans to pick up \$10.70 cents. I am asking them to pick up 20 cents or less of that cost.

To give you an example in the lower 48, because today we will hear arguments undoubtedly that Alaska doesn't have roads, well, here in Washington, we have roads. In Toledo, Ohio, we have

roads. In you were if you were to ship 150 pounds of goods some 400 miles, let's say, from here to Toledo via UPS it would cost approximately 80 cents a pound.

Well, in fact to ship that same distance in Alaska costs less than half that. In other words, you can ship by air in Alaska cheaper than you can ship by ground in the U.S. That was not and should not have been the cost of doing business.

If we go to the most efficient way of delivering this freight called Bypass mail to Alaskans, we can save money. Witnesses today will undoubtedly argue that you will destroy passenger travel in Alaska. If that is the case, the question is, should postal ratepayers anywhere, but particularly in the lower 48, subsidize passenger traffic in Alaska or should Alaska seek to receive, as it might well, some portion of FAA money, landing fees, or an appropriation to take care of the need for maintaining subsidized passenger travel in Alaska?

Our bill and the bill that we will consider next week deal with the ability to try to give the opportunity to be more competitive. For some reason, Alaska Air, which operates a fleet of 737-400s, a relatively old aircraft, and only recently upgraded to that, makes the case that their unique ability to haul as a preference this freight at a rate the Department of Transportation sets is essential and that if they have competition attempting to deliver this freight for the same or less, that it will somehow disrupt a carefully designed plan which is working perfectly.

The American people understand this best when one puts it in perspective. To be clear, the excess capacity of these airlines is paid for by the Postal Service. More importantly, the subsidy means that every 6 years the American ratepayer is buying a Bridge to Nowhere. If one were to look at the so-called Bridge to Nowhere in Alaska, what you discover is that in fact it was a bridge to provide access to an airport. I personally am not a user of the Bridge to Nowhere very often, but the level of this subsidy every 6 years rises to the cost of another one of those bridges.

That is why I put forward H.R. 4011, which I believe at a minimum tries to reduce the preferences given to specific airlines carefully crafted to lock out new competition. No American understands why incumbent carriers should be in perpetuity able to have a preference over other carriers operating for at least 1 year in Alaska.

Mr. Chairman, thank you for your indulgence. I yield back.

Mr. FARENTHOLD. Thank you very much.

Mr. FARENTHOLD. And other members will have up to 7 days to submit their opening statements for the record.

Mr. FARENTHOLD. We will now recognize our first panel. We have the junior Senator from Alaska, Mr. Begich, and we have the Honorable Don Young, the Representative to the House from the State of Alaska.

We will start by recognizing Senator Begich.

STATEMENT OF THE HONORABLE MARK BEGICH, UNITED STATES SENATOR FROM THE STATE OF ALASKA

Senator BEGICH. Chairman Farenthold of the subcommittee and subcommittee Ranking Member Lynch and Chairman Issa and Ranking Member Cummings, thank you for the invitation that the

Alaska delegation can make today in these opening remarks. And, again, I look forward to the continued discussion on this issue.

I would also like to submit for the record my written comments, if that is possible, Mr. Chairman.

Mr. FARENTHOLD. They are already part of the record, I believe. Senator BEGICH. Thank you.

As everyone knows, the Postal Service has an obligation under the Constitution to provide universal service to all areas of the Nation. I am here today to shed some light on Bypass mail, a crucial system that allows the Postal Service to fulfill its universal service obligation to Alaska. I am also here to tell you the system is not broken.

Chairman Issa, I appreciate your visit to Alaska a couple of years ago.

There is no doubt Alaska presents some unique challenges to the Postal Service when it comes to universal service. I want to note the hard work that the Postal Service employees put in every day to deliver Alaska mail in a timely manner. In particular, I single out Alaska's District Manager Ron Haberman, who is testifying here today.

Ron, I want to thank you for your hard work for Alaska.

Bypass mail is very important to Alaska, but it also is very important for the Postal Service because it allows universal service to Alaska in the most cost-effective way possible. Before Bypass mail existed, Alaskans still relied on the Postal Service to make shipments. Eighty percent of Alaska communities are off the road system, so we are forced to ship groceries and other necessary items through the mail. When it became clear that the postal facilities couldn't handle the high volume of postal parcel post, the Postal Service established Bypass mail. The system relieves the Postal Service of the need to pay for staff, facilities, and equipment to process these shipments.

Let me make that point very clear: Bypass mail saves the Postal Service money. The savings from using Bypass mail and avoiding the costs of parcel post are estimated to be \$45 million annually. Anyone citing the cost needs to make sure that is factored into the savings.

Last month this committee approved legislation, the intent of which is to increase competition among mainland carriers that deliver Bypass mail in rural hubs, to supposedly save money. However, the bill will actually have the opposite effect, make the system more expensive and less effective for the Postal Service and customers.

Here is why. The Rural Improvement Service Act of 2002 purposely limited competition among mainland carriers because too many carriers were providing mainland service and they didn't have an adequate share of the mainland market. The result was unreliable service for Alaskans and high operating costs for the Postal Service. The bill created an interdependent relationship between mail and passenger service to make the system more cost-effective and reliable.

Remember, Alaska is a fifth the size of the continental United States and has very few roads. When you are covering that many miles, sometimes you need to kill two birds with one stone. Some-

thing to highlight, the Postal Service has not asked for the changes that Chairman Issa has proposed. Why is the chairman pursuing changes that would increase costs for the Postal Service, especially when the Postal Service has stated the current process is the most cost-effective way for it to provide service to Alaska? While the Chairman's proposed legislation might benefit air carriers that want to enter the mainland market, it would not benefit Alaskans or the Postal Service, period.

Let me hit on a couple more points. Chairman Issa has argued that the system benefits businesses more than it does rural residents. Wrong again. Just to point out the issue that we responded to the IG report in regards to your example, on the potato chip package, it didn't incorporate fuel costs, utility costs, healthcare costs, housing and wages that are much more expensive in rural Alaska. It is not as simple as drawn by the presentation. The cost of living is high in rural Alaska, plain and simple. If you charge carriers and small businesses more to provide goods, those expenses will simply be handed down to the communities in the form of higher grocery prices.

Chairman Issa has also argued Alaskans need to pay disproportionately more for their service. This flies in the face of the Postal Service's universal service obligation. We should not have to pay more to receive the same service as other Americans.

While the committee has failed to reach a bipartisan agreement on much-needed postal reform legislation, here we are today debating proposals that would actually cost the Postal Service more money and make the system less effective. These proposals are counterproductive to the overall postal reform effort. I just participated in the Senate committee markup of the postal reform legislation. We need to stay focused on the comprehensive postal reform legislation for the sake of the Postal Service and the American people.

Despite the title of this hearing, Bypass mail is not broken. The system is far from it. Alaskans are open to change to make the system more effective, but I urge the committee to reject any changes that would violate universal service for Alaska or make the Bypass mail system more expensive for the Postal Service or my constituents.

Finally, I urge the committee to consult both the Alaska delegation and the Postal Service before proceeding with any proposed changes.

Thank you, Mr. Chairman. I am happy to answer any questions. Mr. FARENTHOLD. Thank you very much, Senator.

[Prepared statement of Senator Begich follows:]

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 GOVERNMENTAL AFFAIRS
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 RELATIONS, AND THE DISTRICT OF COLUMBIA

MARK BEGICH
 ALASKA

United States Senate
 WASHINGTON, DC 20510

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**STATEMENT OF
 UNITED STATES SENATOR MARK BEGICH
 BEFORE THE
 SUBCOMMITTEE ON FEDERAL WORKFORCE,
 U.S. POSTAL SERVICE AND THE CENSUS
 UNITED STATES HOUSE OF REPRESENTATIVES**

March 4, 2014

Thank you for inviting the Alaska Delegation to make opening remarks today. As everyone knows, the Postal Service has an obligation to provide universal service to all areas of the nation. I am here today to shed some light on Bypass mail, a crucial system that allows the Postal Service to fulfill its universal service obligation to Alaska. I am also here to tell you the system is not broken.

Chairman Issa, I appreciate your visit to Alaska a couple years ago and the fact that you came to recognize the importance of the system after your visit. However, you continue to propose changes that would infringe on Alaska's right to universal service, or that would make the system more expensive and less effective for the Postal Service and my constituents. The changes you have proposed are unacceptable. Before making any changes to the system, this committee should fully understand their effects on universal service for Alaska and on the Postal Service's bottom-line in the context of broader Postal Reform legislation.

Alaskans are open to discussing ways to make the system more efficient, but we will oppose any changes that violate universal service or make the Postal Service worse-off. It might help if you come back to Alaska – and maybe this time the Alaska Delegation can have the opportunity to show you around and share our perspective. I also invite the Ranking Member and any other members of the Committee to see firsthand how this system works, and the people and communities it affects.

There is no doubt Alaska presents some unique challenges to the Postal Service when it comes to universal service. I appreciate the hard work Postal Service employees put in every day to deliver Alaska mail in a timely manner. In particular, I would like to thank Alaska District Manager Ron Haberman, who is testifying here today, for all of his hard work for Alaska.

In order to understand why Bypass mail is necessary to universal service, you need to understand its history. Before Bypass mail existed, Alaskans primarily used Parcel Post to make shipments of goods to rural communities. As 80 percent of Alaska communities

SUITE 300
 514 L STREET
 ANCHORAGE, AK 99501
 (907) 271-5915

SUITE 339
 101 12th AVENUE
 FAIRBANKS, AK 99703
 (907) 454-0261

SUITE 308
 ONE SEALASKA PLAZA
 JUNEAU, AK 99801
 (907) 586-7750

SUITE 101
 405 FRONTAGE ROAD
 KENAI, AK 99611
 (907) 283-4000

SUITE 230
 1900 FIRST AVENUE
 KETCHIKAN, AK 99901
 (907) 225-3000

SUITE 208
 881 EAST WESTPOINT DRIVE
 WASILLA, AK 99654
 (907) 367-9956

SUITE SR-111
 RUSSELL BUILDING
 WASHINGTON, DC 20510
 (202) 224-3004

are off the road system, Alaskans are forced to ship groceries and other necessary items through the mail. When it became clear that postal facilities could not handle the high volume of Parcel Post, the Postal Service established Bypass mail. The system relieves the Postal Service of the need to pay for staff, facilities and equipment to process these shipments. Let me make that point very clear: Bypass mail saves the Postal Service money.

Last month, this Committee approved legislation on Bypass mail by voice vote without consulting either the Postal Service or the Alaska Delegation. The intent of Chairman Issa's proposed legislation, H.R. 4001, is to increase competition among mainline carriers that deliver Bypass mail to rural hubs. However, while the bill intends to increase competition, it would not save the Postal Service any money. In fact, it would make the system more expensive and less effective. In 2002 Congress enacted the *Rural Improvement Services Act*, which put into place the current criteria to become a mainline air carrier. The bill purposely limited competition in the system.

Before 2002, too many air carriers were providing mainline service, so the participating air carriers did not have an adequate share of the mainline market. The result was unreliable service for Alaskans and high operating costs for the Postal Service. The current requirements for mainline carriers were set up to improve service and save the Postal Service money. The interdependent relationship between mail and passenger service is absolutely necessary for the system to be cost-effective and reliable. Remember: Alaska is a quarter the size of the continental United States and has few roads. When you are covering that many miles, sometimes you need to kill two birds with one stone.

Let me be clear: the Postal Service has not asked for the changes Chairman Issa has proposed. Why is the Chairman pursuing changes that would increase costs for the Postal Service? Especially when the Postal Service has stated the current process is the most cost-effective way for it to provide service to Alaska. While the Chairman's proposed legislation might benefit air carriers that want to enter the mainline market, it would not benefit Alaskans or the Postal Service. Period.

Chairman Issa has suggested the current system helps air carriers and small businesses more than it does rural residents. Wrong again. The cost of living is very high in rural Alaska – plain and simple. If you charge air carriers and small businesses more to provide goods, those expenses will simply be handed down to communities in the form of higher grocery prices.

Chairman Issa has also proposed legislation disproportionately charging Alaskans higher rates than other Americans for their mail service. These proposals fly in the face of the Postal Service's universal service obligation. It is true Bypass mail is a unique system; but Alaska is a unique state, with unique challenges. The Bypass mail system gives the

Postal Service the tools it needs to provide universal service and handle the challenges of Alaska's geography. We should not have to pay more to receive the same service as other Americans.

Chairman Issa has criticized the cost of the program, but we must be sure to factor in the savings the Postal Service realizes through Bypass mail. Because of the Bypass system, the Postal Service does not have to pay for facilities, equipment and labor that would be needed to process the shipments. The savings from using Bypass mail have been estimated to be around \$45 million annually.

I urge this committee not to get sidetracked from the broader debate on Postal Reform legislation. This committee, so far, has failed to reach a bipartisan agreement on much-needed legislation to restore the Postal Service's financial solvency. Yet here we are today debating proposals that would actually cost the Postal Service more money and make the system less effective. These proposals are counterproductive to the overall postal reform effort. A couple weeks ago, as a member of the Senate Homeland Security and Governmental Affairs Committee, I participated in the markup of S. 1486, the *Postal Reform Act*. We debated a lot of important issues – some of them contentious – but in the end we were able to pass a bill with bipartisan support. We need to get comprehensive postal reform legislation done for the Postal Service and the American people right away.

Despite the title of this hearing, Bypass mail is not a broken system, far from it. While Alaskans are open to improving this system, I urge this committee to reject any changes that would violate universal service for Alaska or make the Bypass mail system more expensive for the Postal Service or my constituents. Finally, I urge the Committee to consult both the Alaska Delegation and the Postal Service to get a full and accurate perspective before proceeding with any proposed changes.

Mr. FARENTHOLD. We will now recognize Representative Young.

STATEMENT OF THE HONORABLE DON YOUNG, UNITED STATES REPRESENTATIVE (AT-LARGE) FROM THE STATE OF ALASKA

Mr. YOUNG. Thank you, Mr. Chairman. I ask unanimous consent to submit for the record, if it is not there, my written statement.

Mr. FARENTHOLD. Without objection, so ordered.

Mr. YOUNG. Mr. Chairman, I again thank you for this hearing, and because I have a written statement I am not going to use it because the Senator has covered most of the subject that I would cover in my written statement, so I will just speak from the cuff.

Mr. Chairman, I will agree on one thing with the Senator, the comment of this hearing, "Alaska Bypass: A Broken System." I don't know where that came from. I don't know why it was used. It is not broken. It is working. It is working quite well. And as the Senator mentioned, why this proposal is before us I don't quite and do not know for sure.

Chairman Issa has a great interest, as I have said before, in legislating in my State, and he is worried about \$70 million lost, supposedly, which would cost the Postal Service probably \$200 million if they were to have just what we call parcel post. And there is a \$15 billion debt in the post office and you are worried about \$70 million that would cost \$200 million. I don't quite understand that. That is what you call picking up peanuts when you have a forest fire in your backyard. It doesn't make a whole lot of sense.

When this system works, it is working well, not only for the rural community, but again I would like to remind my colleagues very straightly, because you are reading, I see one guy up there, Mr. Clay, is on his telephone, and that deeply disturbs me as a chairman. So I would prefer if you would like to listen very carefully. Okay. Okay. All right. That is fine.

You take all the land east of the Mississippi River to the tip of Maine, to the tip of Florida, that is part of Alaska, and in that area you have got 253 Congressmen and 52 Senators. And you have more mileage of highway in that area, 10,000 times more than we do. There are no highways in Alaska. We do have post offices. And the people as American citizens have a right for universal service.

Now, if we wish to do so, we will just go back to the parcel post system. Bypass mail, people don't understand. What it is, it is the products you are going to ship parcel post don't go through the post office. That means you don't need to build more postal buildings. It means you don't have to hire any more people if you want universal services.

Now, I will say the post office attempted to in fact eliminate parcel post in Alaska, and that was changed back to the way it should be.

So we are talking about a situation here that concerns me a great deal because it doesn't make sense to have this bill or the bill that was passed last week moved to the House floor when it has something in it that saves peanuts, when in fact it costs us money, the taxpayer money, the Postal Service money.

Now, we all know that, very frankly, there were some people talking about noncompetition. This is not a new subject. Chairman

Issa has gone to Senator Stevens and advocated for one of his constituents to make it more competitive. The way it was written into law, and it was Senator Stevens, was in fact it is very competitive now. It is not just one. But we couldn't have everybody participating in or you have not enough to make it work.

Now, people say we are subsidizing the passengers. Now, you build me some highways, Mr. Chairman, and I will go along with you. You give me the land back that this Congress took away from Alaska, I will go along with you. You let us have what the statehood said and I will go along with you. Do you know that this Congress took 27 million acres away from the State of Alaska and hodge-podged our map so we can't build a road if we wanted to.

In the IG's report—and, by the way, he is full of it, I mean right up to his eyeballs, and if he is in the room I will say it again, when he says in fact the State of Alaska ought to build more roads. That is the dumbest statement I have heard in my whole life. I doubt if he has ever been to Alaska. If he has, he knows why we can't build roads.

We need this for the people, in fact, in the rural areas of Alaska. We don't need to fix something that is not broken. It does work. We use the potato chip example like we said before. You go into one of those stores, and I used to be in a little side store business in Fort Yukon before we had Bypass mail and I know the what the profit margin is, it is about 1 percent. So let us think about this before we move this bill.

Three people versus 253 Congressmen. Two Senators. Maybe we ought to really think about it. This is not good legislation. It doesn't do what it says it will do. It doesn't fix a system that is not broke. It meddles, and I don't like meddling.

I yield back.

Mr. FARENTHOLD. Thank you very much, Mr. Young.

[Prepared statement of Mr. Young follows:]

U.S. House of Representatives
113th Congress
March 4, 2014

Statement of Congressman Don Young before the Subcommittee of Federal Workforce,
U.S. Postal Service and the Census, House Committee on Oversight and Government
Reform

Hearing: Alaska Bypass: A Broken System
2157 Rayburn HOB

I want to thank Chairman Blake Farenthold and Ranking Member Stephen Lynch for providing me the opportunity to speak before the Committee. The topic of the hearing, the bypass mail system, is one that solely impacts my district, as it is an intra-Alaska system for mail delivery. Given the continued interest Chairman Darrell Issa has shown to legislate in my State, it is beneficial to give other members of the committee an opportunity to learn more about the topic. The title of the hearing itself is an indicator of the lack of knowledge of my State. Our mail system is not broken. One would expect a committee hearing to take place prior to reporting legislation directing massive changes, as occurred last month and as part of the last two postal reform bills, but better late than never.

A road system connecting communities throughout Alaska does not exist and is not feasible. Federal land ownership has carved up the State of Alaska such that it is nearly impossible to build terrestrial roads, thus the need to travel by air. This geographic reality requires the Postal Service to deliver mail by air in order to meet its Universal Service obligation.

The bypass mail system for delivery of Parcel Post was developed in the 1970s in order to provide relief to the Postal Service, as their operations could not keep up with the volume of mail going out to bush Alaska. This delivery system tenders pallets of Parcel Post mail directly from shippers to air carriers, bypassing USPS processing facilities, saving the Postal Service from the costs associated with infrastructure expansion and labor.

However, inefficiencies developed over time. Carriers delivering to bush communities were increasingly adopting mail-only business models, providing no passenger service, instead of supplementing standard operations with mail deliveries. The business plans were designed so that the return trips from these destinations were empty, which is inherently inefficient. Smaller carriers were also entering the mainline market delivering mail between the origination points of Anchorage and Fairbanks and rural

hub airports. Mail contracts were being spread thin, and were pushing the larger more efficient carriers to the point of financial instability. Bypass mail costs were increasing rapidly, due to the number of small, mail-only bush carriers operating at inefficient rates.

Congress addressed these inefficiencies through the Rural Services Improvement Act (RSIA) in 2002. In order to stabilize the market, and decrease mail rates, RSIA mandated carrier qualifications. Air carriers are required to transport a percentage of the passenger traffic or freight volume in order to qualify for mail contracts. These changes increased efficiencies in the market, led to lower rates and costs for the Postal Service, and improved the services provided to rural Alaska.

Chairman Issa has made it no secret of the origins of his interest in this topic. The Chairman met with Senator Ted Stevens when he was advocating on behalf of his friend's company, and discussed his perception that RSIA is noncompetitive. The intention to increase competition in the name of efficiency may seem valid in concept, however, introducing competition into this uniquely regulated market actually works against the purported objective of increasing efficiencies for the Postal Service, and puts us on a path back to the high costs, rate pressures, and degradation of service seen before the market was stabilized by RSIA.

Aviation fuel is expensive, and there is no getting around that fact. However, the argument that this is an unjustifiable subsidy flatly ignores the concept of Universal Service, and the corresponding duty bourn by the USPS. RSIA was drafted to specifically tie into Article I, Section 8 of the U.S. Constitution, which gives Congress the power to establish Post Offices and Post Roads. In Alaska, the bypass mail system is the equivalent of postal roads in the sky.

I like Chairman Issa personally, and appreciate the work of the Committee to hold the Obama Administration accountable, but the Committee is wrong to pursue changes to RSIA that will create no new efficiencies, be detrimental to the economy and air carrier market in Alaska, and potentially damage the quality of life to rural residents. This pursuit is assuredly counterproductive to the committee's goals.

Should legislation pass through the House that is detrimental to Alaska bypass mail, it will assuredly die in the Senate, along with most House items, be they good, bad or harmless. The junior senator from Alaska will assuredly have something to brag about back to our Native communities and air carriers, and he will have this committee to thank for that talking point.

Mr. FARENTHOLD. We appreciate your testimony, as well as the Senator's.

I know, Senator, you agreed to answer some questions. Typically when we have legislators testify, unless they are willing, we don't question them. We do have some questions if you all would be willing to entertain them.

I am going to yield my time to the gentleman from California to ask his questions. Being from Texas, the second largest State, we are over the fact you all are bigger than us now. So I yield to the gentleman from California, another large State.

Mr. ISSA. Thank you. That is how the gentleman won his primary today.

Senator, your statement repeatedly of the guarantee of universal service, I might note for the record that there is no such guarantee in the Constitution. However, in my visits to Alaska, both officially and unofficially, going up to Prudhoe Bay, obviously looking at Bypass mail going to Alaskan islands, I am totally committed to the fact that unless we find other sources of revenue to provide the appropriate subsidy for reaching those islands, that the post office will continue to maintain Bypass mail, because as both of you alluded to, it is more efficient than taking in a bunch of parcels in 70-pound increments. You don't have an argument with me. Both the legislation that has already been passed by this committee and the next legislation deal only with the questions of efficiency.

Now, I might ask why it is that everywhere else companies such as Alaskan Airlines sooner or later have to rebid and they can lose in a rebid, but in Alaska they are guaranteed effectively in perpetuity to have what effectively is a legislative earmark for them to get a certain amount of revenue. Senator, do you have a reason?

And I understand Congressman Young said that we are meddling and that they can't afford—I think he basically said you couldn't afford to have additional competition. Is it additional competition that is objected to, and if that is the case, then couldn't we name a number of maximum vendors, but then allow a bid in which a vendor could lose theirs, whether it is Alaska Airlines or a smaller one?

Senator BEGICH. Mr. Chairman, let me make it very clear again. How it is operated, as you know, in 2002 I wasn't here when the original bill was done. I know Don can—Congressman Young, can talk to it.

Mr. ISSA. You know, Senator, you would not have wanted to be sitting in the office with Ted Stevens telling me not to meddle in Alaska when I asked him why he was locking out existing carriers.

Senator BEGICH. I would be very happy to answer your question. Mr. Chairman, the economy of scale, Alaska Airlines is a dominant player. It creates opportunities to create more efficiency in the delivery of the system. I fly on those flights a lot. I know you came up one time and you went up to Prudhoe. Prudhoe is not a village, okay?

Mr. ISSA. Senator, Prudhoe is where I went to look at other issues. I have been to Alaskan islands on a hydrofoil. I came up to look at Bypass.

Senator BEGICH. Right. And when you went up there, going out to the villages, when we have direct and we have volume players

in there, and Alaska Airlines is a volume player, and I know you are going to have a representative here, you can ask more questions, but in order to do it on economy of scale in Alaska, if you have multiple carriers the odds they will not be able to create the business necessary to keep the prices marketable and fair to the consumer at the end of the day.

Now, you may disagree with that. I come from the private sector just like you. You are much wealthier than me, and I get it. But I come from the small business world. And you always want competition, but you also have to understand this delivery system of parcel post, and I know how you packaged up your comments when you said they put them in big 1,000 packages. Well, that is because it is more efficient. If they didn't do it that way, they would do the 70 pounders and the post office would pay that bill and that shipping cost and it would be passed on.

Mr. ISSA. Senator, that wasn't the question. Would you be responsive to the question? And I want to be very fair to you. You came here to help us. But we are not arguing over changing the efficiencies that are in Bypass mail.

Senator BEGICH. Yes, you are, by the conversation.

Mr. ISSA. No. What we are talking about is excessive stops, additional port stops, if you will, of aircraft; the ability for carriers to bid to do additional work, for additional carriers to bid; and ultimately the possibility that carriers might not carry passengers, but might only carry freight. These are areas we are looking at to try to wrench out 10, 20, 30 million dollars worth of the cost of the existing Bypass mail.

No part of those freight shipments called Bypass mail are we talking about eliminating. We are asking can you in fact, tell us that locking out potential bidders of existing Alaskan airlines that have been doing business in Alaska for more than a year continuously, locking them out of the so-called preference, tell us why that is important, that they will in perpetuity never have an opportunity to replace an incumbent carrier.

Senator BEGICH. Again, Mr. Chairman, in all due respect—

Mr. ISSA. I don't want due respect. I just want the question answered.

Senator BEGICH. That is fine. There is competition in the market. New carriers can enter the system. The issue is, especially in Alaska, when you are flying in Alaska several aspects play into it, not only the competition that we have in Alaska, but also the safety issues and knowing Alaska pilots and knowing Alaska flight areas. This is a part of the equation also. It is not just getting the mail there. It is also the safety of the passengers and getting mail there. There is multiple reasons.

You are not going to get the answer you want from me. I understand that. We are going to disagree on this aspect of what you are proposing.

Mr. ISSA. Senator, the airlines that we are talking about, the three I understand—

Senator BEGICH. I disagree with your premise, Mr. Chairman.

Mr. ISSA. Well, I understand. I just want you to make sure we make the record accurate. The airlines that would be added, I think there are three that under this legislation, there could be

more later, as far as I know they are able to carry this same freight, they are safe enough to be able to carry. They are just locked out from the preference. Additionally, there is, what, \$870 per thousand if a plane simply lands one additional time even if bypassing that might be efficient for carrying the mail. These are the areas we are dealing with.

And I think it is important that the record be clear. Are you saying that these other three carriers would not be safe to carry milk or vegetables or cans of Coke?

Senator BEGICH. I am saying that safety is part of the equation. But let me just say this.

Mr. ISSA. But what level of safety do you need for a can of Coke?

Senator BEGICH. Mr. Chairman, I am not going to go back and forth with you. Maybe you want to. I have seen how some of these hearings work. I operate differently in the way we have conversations. I am not going to go back and forth with you over the same argument.

I will just tell you this. The Senate has passed out of the committee in a bipartisan way a comprehensive postal reform bill that puts the postal reform on the right track with ensuring Bypass mail stays in the way it is because it is a small piece of the puzzle and does it efficiently. We have been able to balance the budget on the Postal Service and doing it the right way with the Senate bill and looking at all these issues, and Bypass mail, as it is today, which I will go back to my original quote, it is not broken, despite this committee hearing's title. And we were able to do it with Democrats and Republicans in a bipartisan way on the Senate side.

Mr. FARENTHOLD. Thank you very much.

Mr. YOUNG. May I make a comment?

Mr. FARENTHOLD. If you would like to comment for a moment, Mr. Young, absolutely. Did you have something you wanted to add?

Mr. YOUNG. You know, this is about safety and efficiency. If you open for bid, I can come in, I know on the bill it says I believe they are supposed to be operating 6 months, I think that is correct.

Mr. FARENTHOLD. I think it is a year.

Mr. YOUNG. A year before they can bid? But you remember this system has been working for a period of time where each carrier now has a system by equipment, loading capability, and, in fact, if you had another competitor would he guarantee passengers back to the home base? If he just wants to supply Bypass mail he would have to raise the rates because there is no passengers.

Alaska Airlines has passengers. I think that is crucially important to remember. This is about saving money and making sure that the planes are safe. Now, that may be up to the FAA. I don't know. I mean, that is something we have to think about, the system. We have not had an accident. We have delivered the mail. There hasn't been any real problems. I mean, that goes back is it broken? Are we just looking for a problem? That is all.

Mr. FARENTHOLD. We are a little over on Mr. Issa's time—or my time—and Mr. Cummings has indicated he would like to go to Mr. Clay first.

So, Mr. Clay, you are recognized for an equal amount of time.

Mr. CLAY. Thank you, Mr. Chairman.

And thank you, my friend from Maryland, the ranking member, for yielding.

Senator Begich, welcome to the friendly confines of the House Oversight and Government Reform Committee. You know, on December 2, 2011, the Alaska delegation sent IG Williams a letter requesting the findings within the 2011 inspector general's report. Could you elaborate on the delegation's concerns with the report?

Senator BEGICH. Absolutely. Thank you very much for the question.

First off, when you look at it, as I mentioned a little bit earlier in regards to the cost, as I highlighted, that 35 cent bag of chips, shipping, they didn't incorporate all the other costs of that product and therefore that is a huge gap. They also had information regarding the flights, for example, comparing a 144-seat passenger planes to 36-prop passenger planes and making them equal, which is incorrect.

We went through a list of items. The infrastructure cost, how is that incorporated? If I took the position, and I do, and I would love more roads, as Congressman Young said, if you suddenly say we don't want Bypass mail, then there is a substitute, parcel post, like everyone else can get. They can drive and deliver parcel post. Well, okay, where is that road construction money, that cost factor? None of these things are put into this discussion in the IG's report. We detail that, as you noted, 2-1/2 pages by the delegation, which we think are legitimate issues that detail out why the system today is not broken and is efficient. It is very efficient in the delivery of the system.

So as I said on the costing, the shipping, the amount of travel, the savings, they never incorporated. They never asked the post office how much are they saving by not doing this. Well, it is \$35 million bucks. Well, where is that in this equation? That should be incorporated.

So there are several items that we highlighted that we think should be taken into account when you are looking at this system. And that is what it is. It is not a program. It is not a subsidy in the sense like people like to make other programs. This is a postal delivery system. I mean, I would just venture to guess an envelope from California to D.C. costs more than an envelope going from southern California to maybe a town across the street, but the postal cost is the same.

Mr. CLAY. And I do empathize with your position, having just finished a recent trip to the North Pole. And I was in a place called Churchill, Manitoba on Hudson Bay, pretty close to the North Pole. And it was a remote town. There were no roads leading in or out. The only way there was through train service, by rail or by plane. And, yes, the cost of goods and services were much higher in that town.

Let me move on to Representative Young. I hope you are not reading your BlackBerry, Representative Young.

Mr. YOUNG. I have never read my BlackBerry in my life. The day I turn that sucker on is the day I am going to walk out of these halls, I will tell you that right now.

Mr. CLAY. You know, for the life of me I cannot understand why we are having this hearing on this bill. I mean, maybe you can shed some light on it, to bring—

Mr. ISSA. I can—

Mr. CLAY. No, I am talking to the witness now, Mr. Chair. I am talking to our colleague.

Mr. YOUNG. I really think, in all due respects to the chairman of the full committee, it was being held because Mr. Cummings and Mr. Lynch raised this point on the letter I wrote, and I do think this is why this hearing is being held. I believe the same provisions are in the major bill that was voted on, and now we can go to the floor and say we had a hearing. I think that is the main reason.

But the reality is, this will inform you, I think, a little bit about the challenges we have in the State of Alaska. I have said before, if you guys help me build some roads, I will be all for it. We have a broken infrastructure system in the lower 48. We don't have any infrastructure of any consequence in the State. Remember how many miles of road.

So we need to have universal service for the post office. The post office is losing money. There is no doubt about that. And I hope in the postal reform we will finally solve the problem and allow them to make some money. But \$70 million, when it is going to cost about \$200 million to do what they are losing on \$70 million, to me that is a \$130 million profit, any way you want to cut it. So I don't know.

Mr. CLAY. I yield to the gentleman from Maryland.

Mr. CUMMINGS. Congressman Young, the reason why we wanted to hold a hearing is so we would get a better understanding about this mail. I understand that there are unique situations in Alaska, and what we wanted to do was make sure we understood what we were voting on.

And so as I have been listening to the discussion, I wondered, you know, we often hear in the Congress the terms picking winners and picking losers, and I am just wondering, those carriers that are in already, have we now given them a license to be there forever, and what about others that might want to compete? This is just out of curiosity. I mean, this is a question. And I just wondered, if you were on the outside looking in, I mean, how would you handle that?

In other words, if you were a carrier and you wanted to have an opportunity to get in on the action. And I am not saying. I don't know. I am just curious.

Mr. YOUNG. May I address that? I am not locked into any airline's permaturity as far as carrying mail, but I am locked into safety and efficiency. That is what I am locked into. And when you put up a bid, now, I have seen some of the bids the post office puts up, and they may go for the cheapest bid. Now, that is well and good for their bottom line, but that doesn't protect the person that is flying in that airplane or the lack of efficiency receiving the mail.

Mr. CUMMINGS. So if they put up the requirements of a bid were to have the level of safety and the things that you just talked about in there, your concern is, I take it, first of all that they would likely not require those things in the bid, and even if they did, that bidders would, even if they said they were going to do it, they prob-

ably wouldn't perform to the level of safety and efficiency that you are talking about. Is that a fair statement?

Mr. YOUNG. That is what I am saying. And by the way, again, I go back to the post office, they will take the cheapest bid. That is what concerns me. They will take the cheapest bid. And in doing so they can jeopardize the efficiency and the safety.

Mr. CUMMINGS. Okay. Senator.

Senator BEGICH. Very quickly. Also, inherently when you do freight, for example freight coming out of Anchorage going, say, to Bethel or Koyukuk or a small village, that goes out there full up, if it is just a straight freight liner, it comes back empty. What do you think the costs are going to be? They have got to pay for that. So the costs go up. That is why there is this combo. And people who have a combo, they can enter the market now. But you do the combo so then it becomes a more efficient system. It is the similar problem we have with our big boat ships that come up tote. They come up full, they go back empty because we don't have product that we are exporting back to Seattle or Tacoma.

Inherently a straight freight shipper will cost more money in the end product. Now, I know someone will argue differently, but I am telling you, I have flown on those have known on those combi planes, Don Young has flown on those combi planes, half freight, half people. And the reason it is done is because you have got an efficiency to the system, and that is just a fact, and that has been proven by the post office in its analysis of savings.

Mr. YOUNG. Another thing, too. Unless they have the aircraft available, and that is where the bid would come in, if you think you are going to be able to carry this freight in a Caravan, which is a single engine turbo prop, or in a Dash 8, you are not going to meet the requirement. The efficiency goes out the door. And to my knowledge those seeking this new competition within the State don't have any type of aircraft like that. It will probably come, very frankly, someone leasing them from the lower 48 bringing the new aircraft in to get in the direct freight business.

Mr. FARENTHOLD. Thank you very much.

And we will now recognize the gentleman from Georgia for 5 minutes, Mr. Collins.

Mr. COLLINS. Well, in the midst of all the big States discussing here, the small State of Georgia is going to yield its time to the chairman from California.

Mr. ISSA. I thank the gentleman for yielding.

Well, I think the round of questioning helped us a lot in understanding that it is all about passengers. Is that correct, Representative Young? That in fact, notwithstanding everything else, this program, what is basically the current rules tie the hands of the post office, forcing them to give a preference to airlines who carry passengers. Is that correct?

Mr. YOUNG. No, it is not correct. It is forcing them to make it more efficient. If you fly empty, you know this, Mr. Chairman, if you fly empty going back you are going to raise that price of the potato chips up to \$12 a pack.

Mr. ISSA. Well, that begs the question, if the post office has the ability—and I am happy to change this legislation to make it fit the model that you and the post office seem to want—if the post office

has an obligation to get the lowest long-term price, does that meet your requirement?

Mr. YOUNG. Lowest long-term price with efficiency. With efficiency. And you can't be efficient if you don't haul passengers.

Mr. ISSA. Okay. But it is all about passengers.

Mr. YOUNG. No, it is about efficiency.

Mr. ISSA. Well, you know, Don, when I went——

Mr. YOUNG. If you can't have passengers, you will not have efficiency.

Mr. ISSA. Well, when I went up to that Aleutian island on a hydrofoil we went up with freight and we came back without anything. We didn't bring any passengers back.

Mr. YOUNG. You lost money, too.

Mr. ISSA. Well, I didn't, but the hydrofoil, I guess, might have done that. But let's go through the arithmetic that you have been giving up until now. The \$35 million you say it would cost more to do parcel post, that is a number you are good with?

Mr. YOUNG. I think it would.

Mr. ISSA. That is fine. I am fine with that number. They lost \$76 million. Had they billed parcel post rate they would have billed over \$100 million. The arithmetic is that they could raise the price \$41 million, pass only on to the efficiency of the Bypass mail \$41 million in discounts, and everybody walks away happy. The only problem is that is more than my bill is purporting to charge.

The current cost, let's just say round numbers, it is \$100 million, \$110 million to ship if you were shipping parcel post. And by the way, that is almost exactly the number of what it would take for this program to break even, meaning if they used Bypass mail but charged parcel post rates the post office would roughly break even.

And I will take your number, it is a good number, \$35 million in savings. I believe the post office needs to pass on that entire \$35 million that they save by not touching the mail. I am completely in agreement with you. The problem is they pass on tens of millions of dollars of additional discount. The problem is that universal service has a price. The Alaskan who receives parcel post by air, even including discounting the Bypass savings, is still paying less than a parcel post person who gets a package delivered over 1,000 miles or 800 miles or whatever in the U.S. The discount is greater currently than in fact is earned due to Bypass.

And, Senator, I believe Bypass is the most efficient way. I think it could be more efficient if we allow some competition, and we could talk about ways to protect against unreasonable competition. But do you agree that Bypass mail, the portion of the savings that comes from a more efficient distribution, is what should be passed on to the ratepayer, not that plus more?

Senator BEGICH. I will give just a general comment. Not seeing your numbers, and I like to see stuff written down, but let me just make it a broad——

Mr. ISSA. Senator, I was taking Don Young's numbers.

Senator BEGICH. Well, let me just make a broader sweep here.

Mr. YOUNG. He hasn't seen my numbers either.

Senator BEGICH. That is right. I was looking over his shoulder here. But let me take a broader. You made the comment that you will tweak the bill to get it to where it needs to be to make it work.

Well, it is working now. Now, if we want to argue the point about, for example, if you now want to change the system of universal service in the sense of making sure it pays for itself in areas, then we should talking about the Grand Canyon. I could start taking a list of places across the board to deliver that mail.

Mr. ISSA. Senator, I will tell you, on this side of the dome I am happy to hear you out as long as you want to talk. But I asked you a question about the level of discount. I have already said I believe Bypass mail should be maintained. What I am looking to do in this legislation is to have as much free market competition as possible. If there is an explicit subsidy for passenger, not an efficiency but a subsidy for passenger, I want that to be measured in a way that everyone knows that it is open and transparent. But most importantly, if we can find ways to lower the cost, I want to lower the cost, because currently the discount given for Bypass mail is greater than the savings versus parcel post, which it was an alternative to.

Now, to be honest, we are arguing over about \$20 million and three companies that might be able to enter the market, at least measured under this current legislation. It is not a lot of money. It is more a matter of principle, that I want to make sure that the post office is allowed to seek the most competitive vendors. And if you want to have a discussion about what those vendors must do and maybe they have to be in business for 5 years, that is fine.

When I went up to Alaska the first time, I saw tail dragger, gas burner, they weren't DC-3s, they were more like DC-5s, but they were cousins, big cousins of a DC-3, and those were carrying postal freight in some of the oldest planes I had ever seen. So I have seen a lot of old ragged planes carrying postal freight.

The question isn't, is Alaska a first class airline? It is. Is Alaska an efficient carrier? I believe it is. But that is not the whole system and that is not really what we are talking about.

Chairman Young, Don Young, quite frankly, he is always going to be a chairman to me, he made the point about those single engine props. Well, they will carry a lot of those locations. Alaska Air carries a relatively few number of locations but a lot of freight. And as you know, small singles and light twins are carrying a lot of the freight. That is really where I suspect that some of the efficiency could be, if they were to Bypass a stop here or there, deliver more appropriate for the needs of freight, maybe less appropriate for the desire of passengers.

That is what this discussion is about, and I hope you could ask me will I work with you to achieve certain things and then tell you us what you want to achieve rather than saying there is no savings here. The post office and the IG are going to get up after you and they are going to say, yes, there is. I am quite sure of that.

Senator BEGICH. Mr. Chairman, I guess my comment back to you would be that we have done this work on the Senate side I think with fair deliberation on the overall issue on the budget of the post office in trying to get a solid bill that pulls the post office in a broad, back to breaking-even-plus, in order for it to survive.

Bypass mail, as we are sitting here, to be frank with you, I will talk Bypass mail forever, but to spend this kind of amount of time on what you just claimed a \$20 million issue seems why taxpayers

are more outraged with us than ever before, when it is a multibillion dollar issue. We have a bill that we passed that dealt with Bypass mail and everything else.

Mr. ISSA. Senator, as far as we know, your bill didn't touch Bypass mail.

Senator BEGICH. Because we don't think it is broken, Republicans and Democrats.

Mr. ISSA. And most of the savings came from a transfer from the post office to Medicare. It is no net savings to the unified bill.

Senator BEGICH. On the overall bill, I beg to differ. Senator Coburn, who is fairly conservative I would say, who supported the bill coming out of committee as the ranking member, I wouldn't think he would pass a bill that, one, cost money, doesn't show savings, and doesn't solve the problem long term.

Senator BEGICH. He even, through the discussions we had in that committee, saw no need to modify or change Bypass mail because it wasn't broken. Other elements of the post office are broken. That is where we should be spending our time.

Mr. FARENTHOLD. We are getting a little beyond the scope of where we get here overall postal reform versus the more focused look at the Alaska Bypass mail system. At this point, I think we do need to move on to our other witnesses, Let Representative Young and the Senator get back to work for the people.

Mr. YOUNG. Thank you, Mr. Chairman, and thank you, Mr. Chairman, two chairman up there. As chairman and chairman, I do appreciate the hearing. I am still willing to sit down and talk to people about solving, if there is a problem, if there is something we can do together. But right now, it ain't broke, don't fix it.

Mr. FARENTHOLD. Thank you very much. Now we will take a short recess while the clerks set up for the next panel.

[recess.]

Mr. FARENTHOLD. Well, we are back, and we will now recognize our second panel.

Mr. Ronald Haberman is the Alaska district manager for the United States Postal Service. Ms. Tammy Whitcomb is deputy inspector general for the Postal Service Office of Inspector General. Mr. Dennis Devany is deputy director of the Office of Aviation Analysis in the Office of Aviation and International Affairs at the Department of Transportation. Mr. Steve Deaton is senior vice president at ACE Air Cargo. And Mr. Jeff Butler is vice president of customer service, airports, and cargo for Alaska Airlines.

Pursuant to committee rules, all witnesses will be sworn in before they testify. Would you please rise and raise your right hand, please. That was two pleases.

Do you solemnly swear or affirm that the testimony you are about to give will be the truth, the whole truth, and nothing but the truth?

Let the record reflect that all the witnesses answered in the affirmative. You all may be seated.

We've received your written testimony, so in order to allow time for discussion, please try to limit your testimony to 5 minutes. Your entire written statements are a part of the record. You should see in front of you a red, yellow, and green light. Much like when you're driving, green means you're doing good, yellow means hurry

up, and red means stop. So we will now start our testimony with Mr. Haberman.

You are recognized for 5 minutes, sir.

STATEMENT OF RONALD S. HABERMAN

Mr. HABERMAN. Good afternoon, Chairman Farenthold and members of the committee. My name is Ronald Haberman, and I serve as the district manager of the Postal Service's Alaska District. I have been employed by the Postal Service for 29 years, and I have been a resident of Alaska for nearly 18 years.

Thank you, Mr. Chairman, for calling this important hearing on Alaska Bypass service. I am pleased to be here today to provide a historical overview of Bypass mail delivery in Alaska and to explain how the current system works. I will also discuss the differences between Alaska Bypass mail and standard post, previously known as parcel post, and some of the costs associated with bypass service.

The State of Alaska is vast in geography with no roads connecting the majority of its communities. Mail is transported via airplanes, helicopters, hovercraft, and ferries. While a very limited road system allows some areas to be reached by surface vehicles, nearly all mail must at some point be transported by air in order to reach its final destination.

Bypass mail service came into existence in the early 1970s when increased parcel post volume, which at that time included mail delivered to bush communities, began to exceed the Postal Service's operational facility and infrastructure capacities. Bypass mail is prepared by an authorized shipper, tendered directly to mainline and bush carriers, and then delivered to the addressee at final destination. Items that flow through the Bypass process are not collected, transported, or delivered by the Postal Service. These items bypass originating and designating postal operations, thereby incurring no cost for Postal Service infrastructure, such as labor, facilities, processing, and equipment.

The Department of Transportation is the sole rate-making authority for all intra-Alaska mail transportation. Alaska is the only remaining regulated air environment, which means the Postal Service is not authorized to negotiate rates directly with air carriers except under limited circumstances.

There are stark differences between Bypass mail and standard post. Standard post consists of single packages that must adhere to weight and size restrictions and enters the Postal Service system via contact with postal retail or delivery employees. The packages are processed and delivered within the Postal Service's infrastructure.

Alaska Bypass service consists of goods and commodities that are similar to freight and cargo that is shipped in bulk on pallets to rural communities. The pallets far exceed the Postal Service's maximum weight limit of 70 pounds and are prepared in a warehouse and inducted into air carrier facilities for transportation and delivery.

Alaska Bypass service allows businesses, which typically include popular big box wholesalers with locations in Anchorage and Fairbanks, to ship directly to rural customers, usually retail merchants,

schools, and medical clinics using a hub-and-spoke system. These recipients order goods and supplies from an approved Bypass shipper who processes the order and tenders it to an approved Bypass air carrier based at acceptance point airports in Anchorage or Fairbanks. The assigned Bypass air carrier transports the order to a hub community where the large pallets are tendered to bush air carriers who deliver the items to the recipients.

Goods shipped via Bypass mail must be ordered from authorized shippers in minimum quantities of 1,000 pounds, and Bypass pallets generally travel the same routes and in the same planes as Priority Mail, Priority Mail Express, and First Class mail. The minimum shipping price for a Bypass mail order is \$365. Last year, 87.5 million pounds of Bypass mail was delivered.

The Postal Service incurred \$109 million in transportation costs and \$32 million in revenue for Bypass mail service in fiscal year 2013. This means that Bypass mail costs exceeded revenue by \$77 million. However, transporting mail to customers and post offices in remote areas of Alaska is a part of the Postal Service's universal service obligation. Although the measures the Postal Service takes to deliver to remote areas of Alaska are unique, operating delivery services to some locations at a loss are not. For instance, the Postal Service loses money transporting mail to customers at the bottom of the Grand Canyon using mule trains. Nonetheless, as part of the Postal Service's statutory mission to provide prompt, reliable, and efficient service to all communities, these addresses must receive the same level of commitment to delivery as all others across the United States.

Bypass mail is a cost-effective and efficient way to handle items that would otherwise require processing through the postal infrastructure. If the Postal Service were to process Bypass mail through in-house operations, it would incur substantial transportation, facility, and labor cost.

Mr. Chairman, this concludes my remarks. I would be pleased to answer any questions.

Mr. FARENTHOLD. Thank you very much, and you gave back some time. Always a winner with that.

[Prepared statement of Mr. Haberman follows:]



**STATEMENT OF
ALASKA DISTRICT MANAGER
RONALD S. HABERMAN
BEFORE THE
SUBCOMMITTEE ON FEDERAL WORKFORCE,
U.S. POSTAL SERVICE AND THE CENSUS
UNITED STATES HOUSE OF REPRESENTATIVES**

MARCH 4, 2014

Good afternoon, Chairman Farenthold and members of the Committee.

My name is Ronald S. Haberman, and I serve as the district manager of the Postal Service's Alaska District, which includes 1,567 employees, working at over 295 facilities, serving more than 735,000 customers living and conducting business within the state's 586,400 square miles. I have been employed by the Postal Service for 29 years and I have been a resident of Alaska for nearly 18 years.

Thank you, Mr. Chairman, for calling this important hearing on Alaska Bypass Service. I am pleased to be here today to provide a historical overview of bypass mail delivery in Alaska, and to explain how the current system works. I will also discuss the differences between Alaska Bypass Mail and Standard Post (previously known as Parcel Post[®]), and some of the costs associated with bypass service.

While many cities and villages in Alaska are accessible only by sea or air, transporting mail to customers and Post Offices in remote areas of the state is part of the U.S. Postal Service's universal service obligation, and we must serve those addresses as we do all others throughout the nation.

The State of Alaska is vast in geography, yet there are no roads connecting the majority of its communities. Mail is transported via airplanes, helicopters, hovercraft, and ferries. While a very limited road system allows some areas to be reached by surface vehicles, nearly all mail must at some point be transported by air in order to reach its final

destination. This is true for all classes of mail, including First-Class Mail, Priority Mail, Priority Mail Express, Standard Post, and bypass mail.

Bypass Mail Service came into existence in the early 1970s, when increased Parcel Post mail volume—which at that time included mail delivered to the bush communities—began to exceed the Postal Service’s operational and facility infrastructure capacities. The service was given its name to reflect the fact that this mail bypasses handling in a Postal Service facility in order to reach its destination.

Bypass mail is prepared by an authorized shipper, tendered directly to mainline and bush air carriers, and then delivered to the addressee at final destination. Items that flow through the bypass process are not collected, transported, or delivered by the Postal Service. These items bypass originating and designating postal processing operations, thereby incurring no cost for Postal Service infrastructure, such as labor, facilities, processing, and equipment.

Section 5402(g) through (s) of Title 39, United States Code, details the requirements for intra-Alaska mail transportation with regard to air carrier participation and Postal Service equitable tender requirements.

Pursuant to chapter 419 of Title 49, the Department of Transportation is the sole ratemaking authority for all intra-Alaska mail transportation. Alaska is the only remaining regulated air environment, which means that the Postal Service is not authorized to negotiate rates directly with air carriers, except under emergency circumstances.

I mentioned earlier that bypass mail was once included as a part of the product now called Standard Post. In conjunction with the Postal Service’s January 27, 2013, price change, Standard Post was moved to the competitive products category, while bypass mail remained in the market dominant category as its own Package Services product.

There are stark differences between bypass mail and Standard Post. Standard Post consists of single packages that must adhere to weight and size restrictions and enters the Postal Service system via contact with postal retail or delivery employees. The

packages are processed and delivered, or made available for customer pickup, within the Postal Service's infrastructure.

Alaska Bypass Service consists of goods and commodities that are similar to freight and cargo that is shipped in bulk on pallets to rural communities. The pallets far exceed the Postal Service's maximum weight limit of 70 pounds, and the shrink-wrapped goods are prepared in a warehouse and inducted into air carrier facilities for transportation and delivery.

Alaska Bypass Service is an intra-Alaska system that allows businesses, which typically includes popular big box wholesalers with locations in Anchorage and Fairbanks, to ship directly to rural customers (usually retail merchants, schools and medical clinics) using a hub-and-spoke system. These recipients place orders for goods and supplies with an approved bypass shipper. The approved bypass shipper processes the recipient's order, palletizes it, applies postage, and tenders it to an approved bypass air carrier based at acceptance point airports in Anchorage or Fairbanks.

The assigned bypass air carrier transports the order to a hub community where the large pallets are tendered to bush air carriers who deliver the items to the recipients. There are currently six mainline air carriers, ten bush air carriers, and hubs in 20 communities in the bypass mail system.

Goods shipped via bypass mail must be ordered from authorized shippers in minimum quantities of 1,000 pounds, and bypass pallets generally travel the same routes and in the same planes as our premium products (Priority Mail, Priority Mail Express, and First-Class Mail). The minimum shipping price for a bypass mail order is \$365. A single order can include more than one pallet; however, the maximum weight for a single order cannot exceed 50,000 pounds. In calendar year 2013, 87.5 million pounds of bypass mail was delivered.

In fiscal year (FY) 2013, the Postal Service incurred \$109 million in transportation costs and \$32 million in revenue for bypass mail service. This means that bypass mail costs exceeded revenue by \$77 million; however, transporting mail to customers and Post

Offices in remote areas of Alaska is a part of the Postal Service's universal service obligation.

Although the measures the Postal Service takes to deliver to remote areas of Alaska are unique, operating delivery services to some locations at a loss are not. For instance, the Postal Service loses money transporting mail to the Havasupai Indian Reservation at the bottom of the Grand Canyon using mule trains. Nonetheless, as part of the Postal Service's statutory mission to provide prompt, reliable, and efficient service to all communities, those addresses must receive the same level of commitment to delivery as all others across the United States.

I would like to point out that despite its costs, the bypass mail system works well for the Postal Service. Conversely, if the Postal Service were to process bypass mail through in-house operations it would incur substantial transportation, facility, and labor costs. In fact, the Anchorage and Fairbanks processing facilities would see increases of nearly 1.7 million pounds of mail per week. Increasing the footprint of originating and destinating postal facilities, and adding employees to accommodate this type of activity, would be cost prohibitive.

As currently structured, Bypass Mail Service represents the most cost-effective and efficient way to handle items that would otherwise require processing through the postal infrastructure. Postal processing of these items could lead to significant increases in Standard Post volume resulting in gridlock similar to that experienced in the early 1970s with Parcel Post mail.

Mr. Chairman, this concludes my remarks. I would be pleased to answer any questions.

Mr. FARENTHOLD. We'll now go to the deputy inspector general for the Postal Service, Ms. Tammy Whitcomb.
You're recognized for 5 minutes.

STATEMENT OF TAMMY WHITCOMB

Ms. WHITCOMB. Thank you. Mr. Chairman and members of the committee, Alaska Bypass is a unique service not provided anywhere else in the country. It was created in 1972 to ease operational bottlenecks but has come to resemble a freight service rather than typical mail or parcel delivery.

As you can see on the screen, under the program, large orders weighing a minimum of 1,000 pounds are shipped on pallets via air transportation. The Postal Service's normal weight limit for parcels is 70 pounds.

The Alaska Bypass pallets of goods travel from the commercial warehouse via the airline to the merchant's door, bypassing the Postal Service's infrastructure. The Postal Service is required to pay for this air transportation; however, postage is assessed at less than \$30 for every 70 pounds and has no relation to the actual cost.

The Postal Service has lost money on Alaska Bypass every year since its inception. In 2013, the Postal Service paid out \$108 million for Alaska Bypass transportation while it brought in only \$32 million in revenue, losing \$76.8 million.

Keeping the program consistent with its original intent has been challenging. For example, in the late 1980s, the Postal Service began prohibiting shipments of concrete and certain building materials after excesses emerged. In 2002, the program goals were formally expanded to include supporting Alaskan passenger and freight air transport. Thus the program has evolved beyond improving Postal Service operations.

The Postal Service is also restricted in how it operates the program. Changing the Bypass network requires 12 months of public notice in consultation with the government of Alaska. Additionally, in a throwback to the days before airline deregulation, the law mandates that the Postal Service pay air carriers noncompetitive rates set by the Department of Transportation. The Postal Service is required to equitably share Bypass volume among designated carriers, and new carriers must overcome significant hurdles to participate. These features burden the Postal Service with additional costs unrelated to the postal mission.

Alaska is an enormous State with few roads and many communities accessible only by air. We are sympathetic to States facing infrastructure challenges, but national and State infrastructures are typically financed by the Federal Government and the States. Under the current Bypass program, significant support to Alaska's transportation infrastructure is paid for by postage sales outside Alaska.

Postage revenues are collected from postal customers, not taxpayers, and the Postal Service has a duty to collect only such revenues as are needed to provide each service. Programs that do not pay for themselves requires cross-subsidization from other products and customers, which is normally prohibited for the Postal Service. Moreover, our research suggests that Alaskans buying goods

shipped through Alaska Bypass do not appear to benefit from this transportation subsidy. For example, in the towns our staff visited, a tube of toothpaste cost \$1.10 more than in Anchorage even though shipping costs through the Bypass program were as low as 14 cents. Also, the University of Alaska, Fairbanks, has found that the same basket of groceries can cost more than twice as much in some Bypass hubs than in Anchorage.

One possible reform is to end Alaska Bypass and return freight shipment to the private sector. If Congress wishes to retain Alaska Bypass, we developed several options for consideration. The Postal Service could be given freedom to operate Alaska Bypass more efficiently by ending the 12-month notice and consultation period. Statutory restrictions that prevent new carriers from entering the market and that restrict competition could be removed. The Postal Service could charge higher rates to make the Alaska Bypass self-sufficient and eliminate its burden on other postal customers.

Alternatively, the Federal Government or the State of Alaska could reimburse the Postal Service for its Alaska Bypass losses. The Alaska Permanent Fund, which was established to invest Alaska's oil and mineral revenues, has a balance of almost \$50 billion that earns interest. The postal losses from Alaska Bypass would be just 2.6 percent of the nearly \$3 billion that the fund earned last year.

Delivering mail and parcels anywhere in the United States, regardless of geography, is the Postal Service's primary responsibility to the American people. But this universal service obligation has no relation to Alaska Bypass. Reforming the program should not affect universal mail and parcel services to Alaskans or to any other American. Thank you.

Mr. FARENTHOLD. Thank you very much for your testimony.

[Prepared statement of Ms. Whitcomb follows.]

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



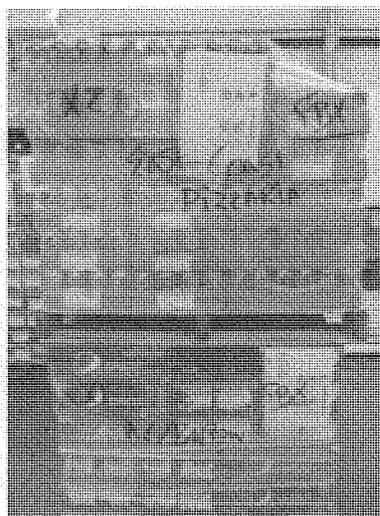
Oral Statement

March 4, 2014

Tammy Whitcomb
Deputy Inspector General
United States Postal Service

Mr. Chairman and members of the committee, Alaska Bypass is a unique service not provided anywhere else in the country. It was created in 1972 to ease operational bottlenecks but has come to resemble a freight service rather than typical mail or parcel delivery. Under the program, large pallets weighing a minimum of 1,000 pounds are shipped via air transportation. The Postal Service's normal weight limit for parcels is 70 pounds.

The Alaska Bypass pallets of goods travel from the commercial warehouse via the airline to the merchant's door bypassing the Postal Service's infrastructure. The Postal Service is required to pay for this air transportation. However, postage is assessed at less than \$30 for every 70 pounds and has no relation to the actual costs.



Alaska Bypass pallets at warehouse in Fairbanks, ready for air transportation to Barrow.

The Postal Service has lost money on Alaska Bypass every year since its inception. In 2013, the Postal Service paid out \$108 million for Alaska Bypass transportation, while it brought in only \$32 million in revenue, losing \$76 million.



Goods are picked at the warehouse in Fairbanks for bundling onto Alaska Bypass pallets.

Keeping the program consistent with its original intent has been challenging. For example, in the late 1990s, the Postal Service began prohibiting shipments of concrete and building materials after excesses emerged. In 2002, the program goals were formally

expanded to include supporting Alaskan passenger and freight air transport. Thus, the program evolved beyond improving Postal Service operations.

The Postal Service is also restricted in how it operates the program. Changing the Bypass network requires 12 months of public notice and consultation with the government of Alaska. Additionally, in a throwback to the days before airline deregulation, the law mandates that the Postal Service pay air carriers non-competitive rates set by the Department of Transportation. The Postal Service is required to equitably share Bypass volume among designated carriers, and new carriers must overcome significant hurdles to participate. These features burden the Postal Service with additional costs unrelated to the postal mission.

Alaska is an enormous state with few roads and many communities accessible only by air. We are sympathetic to states facing infrastructure challenges, but national and state infrastructures are typically financed by the federal government and the states. Under the current Bypass program, significant support to Alaska's transportation infrastructure is paid for by postage sales outside Alaska.

Postal revenues are collected from postal customers, not taxpayers, and the Postal Service has a duty to collect only such revenues as are needed to provide each service. Programs that do not pay for themselves require cross-subsidization from other products and customers, which is normally prohibited for the Postal Service.

Moreover, our research suggests that the Alaskans buying goods shipped through Alaska Bypass do not appear to benefit from this transportation subsidy. For example, in the towns our staff visited, a tube of toothpaste cost \$1.10 more than in Anchorage, even though shipping costs through the Bypass program were as low as 14 cents. Also, the University of Alaska Fairbanks has found that the same basket of groceries can cost more than twice as much in some Bypass hubs than in Anchorage.

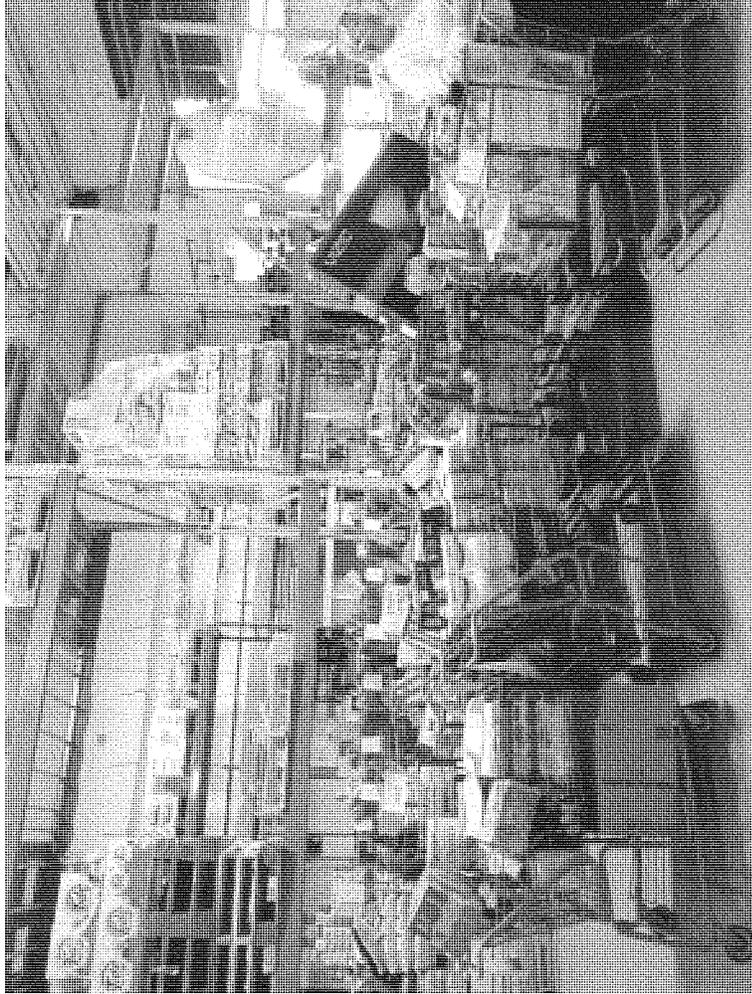
One possible reform is to end Alaska Bypass and return freight shipment to the private sector. If Congress wishes to retain Alaska Bypass, we developed several options for consideration:

- The Postal Service could be given operational freedom to operate Alaska Bypass more efficiently by ending the 12-month notice and consultation period.
- Statutory restrictions that prevent new carriers from entering the market and that restrict competition could be removed.
- The Postal Service could charge higher rates to make the Alaska Bypass self-sufficient and eliminate its burden on other postal customers.
- Alternatively, the federal government or the state of Alaska could reimburse the Postal Service for its Alaska Bypass losses. The Alaska Permanent Fund, which was established to invest Alaska's oil and mineral revenues, has a balance of almost \$50 billion that earns interest. The postal losses from Alaska Bypass would be just 2.6 percent of the \$2.9 billion that the fund earned last year.

Delivering mail and parcels anywhere in the United States, regardless of geography, is the Postal Service's primary responsibility to the American people, but this universal service obligation has no relation to Alaska Bypass. Reforming the program should not affect universal mail and parcel services to Alaskans or to any other American. Thank you.



1. Pallets of a wide variety of goods, such as the soda pictured here, are delivered to warehouses in Anchorage and Fairbanks.



2. Merchants in rural Alaska place orders of at least 1,000 pounds of goods to these warehouses. Pickers gather the goods to assemble the orders.



3. The orders are assembled on pallets and shrinkwrapped for shipment.

Mr. FARENTHOLD. We'll now recognize the deputy director of the Office of Aviation Analysis for the Department of Transportation. That would be Mr. Dennis Devany.

Devany is correct, right?

STATEMENT OF DENNIS DEVANY

Mr. DEVANY. Yes.

Mr. FARENTHOLD. If you could make sure your microphone is on, please, sir. Press the "talk" button.

Mr. DEVANY. Okay. I'm not good at this.

Mr. FARENTHOLD. And you need to bring the microphone a little bit closer. We are all dying to hear what you have to say.

Mr. DEVANY. Yeah, I'm sure. And I sat on my glasses yesterday. My wife found 10-year-old glasses, so I can barely see.

But in any event, thank you, Mr. Chairman and members of the committee. I appreciate the opportunity to be here. Am I too loud?

Mr. FARENTHOLD. No, you're great. You're knocking it out of the park.

Mr. DEVANY. Okay. I'm not good at this, so I don't know.

DOT is required by statute to set intra-Alaska mail rates. I can read what the statute says, but you guys probably already know it. I've done written testimony. It's fairly detailed and boring, and so I'll try and kind of just do an overview here.

First of all, the rates we set have nothing to do with the price of stamps. It doesn't have anything to do with you put a stamp on a mail. The rates we set are what the Postal Service pays to the airlines to carry a ton of mail a mile or whatever distance.

When Congress deregulated the airlines in 1978 and they said anybody can fly wherever they want, charge whatever they want, an exception was made for intra-Alaska mail rates. The mail system in Alaska comprises both what we consider regular mail, which is where you put a stamp on a mail, and Bypass, which is the focus, obviously, of this hearing.

And Bypass takes its name from the fact that it bypasses the Postal Service. They don't take physical possession of the mail. If a shipper from a big box store, as I think Mr. Haberman mentioned earlier, wants to send something from Anchorage to Bethel, they contact the Postal Service, the Postal Service will say give it to Carrier A or Carrier B, depending on who had the last shipment.

There's two elements to the mail rate. Basically what we call the terminal charge and the linehaul charge. The terminal charge means how much does it cost to get a ton of mail on this airplane, irrespective of distance. You know, you got to get a forklift, you got to do something to get it on the plane. The linehaul is how far does it fly, and that costs fuel, that costs pilots, maintenance, and so on. And those are the two rates we set. It's the terminal and the linehaul.

Originally, when we took this responsibility over, and it's been a number of years, we conducted an exhaustive study to try and differentiate between the cost to carry mail, the cost to carry cargo, passengers. Passengers walk onto an airplane, mail doesn't. Mail can offload cargo if the plane is overloaded.

In any event, we went through an exhaustive study, established what we call base rates. Since then, we have done an update, much

like you'd update with the Consumer Price Index or any other index. We don't use CPI. We use cost per available ton mile. The assumption in our methodology is that if the unit cost of flying an airplane in Alaska goes up 2 percent, the mail rates go up 2 percent. If you go down 1 percent, the costs go down 1 percent.

The only other refinement, if I can call it that, we've done to that, I think it was in 1999, we did a fuel surcharge when fuel was going up steadily. Now we do quarterly fuel surcharges, so we adjust the rate.

Other than that, we set the rates every year, and it's a fully transparent process. We issue, we call it a show cause order. It says this is what we think the rates should be, we have all the underlying data, costs, unit costs, and people can say, they have an opportunity to object if we have done our arithmetic wrong, if we have done something else wrong, and then we take those comments, of course, into consideration. And then we issue a final order, and that's it for the next year, and then we do it annually.

So I hope I helped.

Mr. FARENTHOLD. That's a great overview of the process. We appreciate your enlightening us.

[Prepared statement of Mr. Devany follows:]

**STATEMENT OF DENNIS J. DEVANY
DEPUTY DIRECTOR, OFFICE OF AVIATION ANALYSIS
U.S. DEPARTMENT OF TRANSPORTATION
before the
Subcommittee on Federal Workforce, US Postal Service and the Census
Committee on Oversight and Government Reform
U.S. HOUSE OF REPRESENTATIVES**

March 4, 2014

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

Introduction

I appreciate the opportunity to appear before you to discuss the technical aspects of the Department's role in setting intra-Alaska mainline mail rates. The Department has performed this role for many years at the direction of Congress. For intra-Alaska mail rates, 49 U.S.C. Section 41901 requires the Department to:

“Prescribe and publish after notice and an opportunity for a hearing on the record, reasonable prices to be paid by the Postal Service for the transportation of mail, and the services related to the transportation of mail...”

The Department's role has nothing to do with the price that a shipper pays to the Postal Service for stamps. Rather, the Department's set the rates the Postal Service pays airlines to carry intra-Alaska mail, including “bypass” mail. In addition, the Department's role is limited to *intra*-Alaska mail rates; the Department plays no role with respect to mail that either begins or ends outside of Alaska.

Overview of the Intra-Alaska Mail System

When Congress deregulated the airline industry in 1978, an exception was made for intra-Alaska mail rates. The mail system in Alaska comprises both what is considered “regular” mail and “bypass” mail. Regular mail in Alaska is treated the same as it is in the rest of the country, i.e., the shipper delivers the goods to the Postal Service, pays the postage, and the Postal Service takes possession of the shipment and ensures its delivery. Bypass mail, on the other hand, takes its name from the fact that the mail bypasses all physical handling by the Postal Service. When a shipper wants mail to be transported to a destination, the shipper contacts the Postal Service and the Postal Service instructs the shipper to deliver the mail to a specific air carrier. Bypass mail is a subcategory of nonpriority mail. Approximately 85 percent of the nonpriority mail is bypass, and the remaining 15 percent is referred to as “in-house nonpriority.” In-house mail is delivered directly to a Postal Service facility, which physically handles it and disburses the mail to a carrier.

While the focus of my testimony is on mainline mail carried on mainline aircraft, the Department also sets mail rates carried by bush aircraft, known as the bush rates. Mainline aircraft are defined as having a payload exceeding 7,500 pounds while bush aircraft payloads are 7,500 pounds or less.

The mainline mail rate comprises two elements -- the linehaul rate and the terminal rate. The linehaul rate varies with the distance that the airlines fly the mail and is expressed as dollars per revenue ton of mail, and the Postal Service pays the airlines on the basis of how many revenue ton miles of mail they carry.

The terminal rate relates to the cost of loading mail onto an aircraft, irrespective of distance, and is typically expressed in dollars per ton of mail enplaned. The Postal Service, in fact, pays the airlines on the basis of mail tons enplaned.

Methodology

In establishing the current mail-rate structure, the Department conducted an exhaustive investigation to determine the actual costs incurred by airlines in carrying the mail. While Congress intended the system to promote an integrated passenger, freight, and mail system, the Department is tasked solely with determining the cost of moving the intra-Alaska mail, and setting the rates accordingly. The Department determined the cost drivers of carrying the mail, by way of a formal hearing in front of an Administrative Law Judge, which included exhibits submitted by stakeholders. The Department addressed myriad issues such as the directionality of mail, the fact that mail can displace cargo if the aircraft is full, debt/equity ratios and returns on both debt and equity, mark-up for income taxes, circuitry etc. At the end of the process, the Department issued an order setting what it still refers to as the "base rates."

Subsequently, the Department has updated the base rates much the same way that other rates are indexed to the Consumer Price Index (CPI). Rather than using the CPI, the Department has used the changes in unit costs of Alaska mainline carriers to adjust the rates up or down. Specifically, for the linehaul rate, the Department compiles all the costs of the Alaska mainline carriers associated with flying the aircraft -- fuel, pilots, maintenance, lease costs, etc. -- and divide by total capacity, defined as available ton miles (ATMs), commonly referred to as the cost per ATM. The Department takes the result and compare it to the base year's results and weight each carrier's unit costs by the amount of intra-Alaska mail that each airline carries. In other words, if there are two carriers of the same size but one carries twice as much intra-Alaska mail as the other one, it would be weighted double.

The Department then derives an aggregate change in unit cost per ATM. Simply put, if the total cost per ATM increases two percent, the Department increase the linehaul rate by two percent. As a final adjustment, the Department recognizes that it is setting rates for a future period based on historical data. Therefore, the Department runs a regression to determine what the long-term (10-year) trend has been in unit costs and adjust the historical data accordingly to project the new rate at the midpoint of the future rate period.

This methodology includes measuring the change in unit costs of *all* traffic -- passengers, freight and mail. The underlying assumption is that, as the airlines' unit costs change due to newer, more fuel-efficient equipment, different labor contracts, insurance rates etc., those changes apply equally to passengers, mail and freight.

The Department follows the same methodology with the terminal rate by examining the total costs of loading traffic onto the airplanes and then divide by total tons enplaned.

The most recent refinement the Department made to the mail-rate system was the introduction of a fuel surcharge in 1999, primarily at the request of the carriers because, at that time, fuel prices were rapidly increasing. It is important to note that, even without the quarterly fuel updates, airlines would ultimately be made whole for the fuel price increases. However, with only *annual* updates and the lag in getting data, it would have taken a year or more for the carriers to recoup rapidly increasing fuel costs. The quarterly adjustments make the rates more responsive to actual fluctuations in costs.

In addition, the Department sets a separate priority and non-priority rate for the linehaul and terminal elements. These rates were established in our original base-rate investigation and they rise or fall together based on the changes in unit costs. Priority rates are significantly higher than nonpriority, and reflect the greater costs of carrying mail on a flight-specific, more time-definite basis; nonpriority rates are lower because they provide the carrier with more flexibility to determine when the mail will move, thus allowing the carrier to efficiently utilize aircraft payload and human resources.

Below is a chart showing all of the current mail rates set by the Department, both mainline and bush. All mainline bypass mail moves on a nonpriority basis.

Intra Alaska Mail Rates Effective on March 4, 2014

<u>Class of Mail</u>	<u>Order</u>	<u>Rate</u>	<u>Payment Parameter</u>
			Linehaul Rate
Mainline, Nonpriority (Bypass)	2013-12-8	\$2.1379	Revenue Ton Miles of Mail
Mainline, Priority	2013-12-8	\$3.5315	Revenue Ton Miles of Mail
Bush Part 121	2013-12-9	\$5.7476	Revenue Ton Miles of Mail
Bush Part 135	2013-12-9	\$14.9341	Revenue Ton Miles of Mail
Bush Seaplane	2013-12-9	\$32.5983	Revenue Ton Miles of Mail
			Terminal Rate
Mainline Nonpriority (Bypass)	2013-12-8	\$662.20	Revenue Tons Enplaned of Mail
Mainline Priority	2013-12-8	\$770.80	Revenue Tons Enplaned of Mail
Bush	2013-12-9	\$850.03	Revenue Tons Enplaned of Mail

Statewide Class Rates

The different mail rates in the classes above are calculated by the Department and applied by the Postal Service on a statewide basis. The Department uses the class rate concept to ensure that the carriers have incentives to control their costs. Under the class rate concept, a single class rate is

developed for all of the members of that class of carriers. For mainline carriers the Department currently includes the costs of five carriers – Alaska Airlines, Era Aviation, Everts Air Cargo, a/k/a Tatonduk, Lynden Air Cargo, and Northern Air Cargo. If an airline's costs are above the average of the class, its profits are reduced. If an airline's costs are below the average of the class, then it enjoys additional profits.

Process

Once a year, the Department issues a show-cause order fully laying out all our calculations and rationale for the rates that the Department is proposing. That order takes the publicly available Form 41 financial and T-100 traffic information provided by the carriers, calculates a "tentative" rate and directs the parties to show cause, within approximately two weeks, why the Department should not make those rates final. Any party may comment on any aspect of the order or object to the show-cause order, raising any issue that it believes should be handled differently. Other parties then have an opportunity to respond to the comments submitted in the record by stakeholders. After considering all the comments, the Department then issues a final order establishing the new mail rates for a new year. Of course, if no parties object to the show-cause order, that order is simply made final.

The data supplied by the carriers – Form 41 and T-100 traffic -- are not special data, but are the same data that all large certificated carriers are required to provide. Thus, there is no additional reporting requirement on the carriers. As with all air carriers, the mainline carriers are required to certify that their data are true and accurate, and the data are periodically reviewed by Department staff.

Transparency

The Department emphasizes transparency in the administration of the intra-Alaska mail rate system. The Department has sought to minimize the administrative costs of the program to the carriers and the Postal Service by using a fully public process in setting the mail rates, while also encouraging all parties to submit comments on the record. While any party can at any time request a full oral evidentiary hearing before an administrative law judge, no party has chosen to do so. The Department believes this reflects the fairness of the system, the accuracy of the rates, and the recognition of that fact by stakeholders.

Conclusion

I hope that I have helped bring some clarity to the Departments' role in setting intra-Alaska mail rates.

Chairman Farenthold, this concludes my testimony. I would be happy to answer any questions you may have regarding the rate-setting methodology DOT uses in establishing intra-Alaska mail rates.

Dennis J DeVany, Chief
EAS and Domestic Analysis Division
United States Department of Transportation

Dennis DeVany currently serves as the Deputy Director of the Office of Aviation Analysis. Prior to that, he served as the Chief of the EAS and Domestic Analysis Division. In that capacity, his primary focus is administering the EAS Program under the Assistant Secretary for Aviation and International Affairs for the US DOT. His other duties involve slots and slot exemptions at high-density airports, establishing intra-Alaska mail rates, working with Capitol Hill on legislative reforms to the program, and a host of other issues affecting the domestic airline industry.

Prior to joining the US DOT, Mr. DeVany worked at the Civil Aeronautics Board (CAB). Congress deregulated the airline industry in 1978 and established the EAS program to guarantee air service to smaller communities. When the CAB was sunset in 1984, the EAS Program was transferred to the US DOT. Mr. DeVany was a charter member of the first team established in 1978 to administer the then brand new program. He has been with the program ever since, becoming the Chief in the early 1990s.

Mr. DeVany received his B.S. in Economics from St. Lawrence University in Canton, NY.

Mr. FARENTHOLD. Our next witness is Mr. Steve Deaton, senior vice president at ACE Air Cargo.

Mr. Deaton.

STATEMENT OF STEVEN DEATON

Mr. DEATON. Thank you, Mr. Chairman. Thank you, members of the committee, for allowing me to come have this opportunity to talk to you today. I've submitted my written testimony, and I have decided to take a little bit of a different tack in my summary. I wouldn't want to bore you with continuing to talk about the uniqueness of Alaska. No doubt it is unique. I think the committee recognizes that, and the people have been pointing that out because it's very important.

I think one of the things that I'd like to talk about is the fact that it sounds like the committee and Congressman Issa and even the Senate through Senator Begich's comments, the goal here isn't to do away with the Bypass mail program. It has the support of the committee and the Congressman and the Senator. And therefore I'd like to talk a little bit about the efficiencies, the competition, the ways to make the system better. And while I agree that the Bypass mail system is not broken, I do have some thoughts on the Rural Service Improvement Act, what it's accomplished and what it is currently doing to the system and the Postal Service as a whole.

A lot of the testimony today is focused on what I would call mainline air carriers. I was involved for 30 years as a retired Postal Service person now. I was around when Bypass mail was rolled out, when the Bethel experiment happened. I managed that process for 25 years. I have submitted my bio. I'm here today as senior vice president of ACE, but I'm talking to you more as from my postal and my 50-year residency in Alaska as my base rather than my current career job.

The issues, as I see them, ensuring passenger service, ensuring freight service for the residents of Alaska, and trying to create efficiencies and cost savings or loss avoidance for the Postal Service, seem to be what's the important thing today. Most of the discussion being mainline carriers, the Rural Service Improvement Act. When it was enacted, there were three mainline carriers up to that point that carried passengers, Reeve Aleutian Airways, Era Aviation, and Alaska Airlines. Today, under the Rural Service Improvement Act, there are still three mainline passenger carriers carrying mail and Bypass mail, Era Alaska, Alaska Airlines, and Penair.

I think it's important to know that the majority of the Postal Service losses don't come from the mainline side. They come from the bush air carrier side, the small carriers that fly mail around the State of Alaska.

Prior to the Rural Service Improvement Act, there were as many as 35 air carriers. The Rural Service Improvement Act came in, was enacted to protect the passenger freight service, and it's done its job. There are now nine Bypass bush carriers left carrying mail in the State. There are still three mainline passenger carriers. In addition, there are three mainline cargo carriers. The mainline industry, in my opinion, is not the issue.

On the bush side, where the majority of postal losses occur, there are some things in the Rural Service Improvement Act that could be improved to provide competition, increase it, and to provide efficiencies. One of those things is called the pool concept. As the congressman referred to earlier, the Postal Service has to give the majority of its mail on the bush side to over 200 destinations to the carriers that carry and qualify for passenger carriage who have the least amount of capacity to move it. Currently today there is more mail transfer from bush carrier to freight carrier or bush carrier to bush carrier than there was before the Rural Service Improvement Act.

If the pool concept were either eliminated or altered, then it would allow for greater competition, there would not be monopoly markets, which there are today in bush Alaska, and the unit cost for bush carriers that is used by the DOT to set rates would have a downward pressure on the Postal Service's cost.

Another element that could be improved would be the equalization policies of the DOT, either straight equalizations or composite equalizations, the latter which brings an immediate savings to the Postal Service by eliminating one of the terminal handling fees that Mr. Devany talked about.

Equalizations bring more competition, both from acceptance point to hub and certainly from acceptance point to bush point, and more efficiencies, along with better service to the communities and lower cost to the Postal Service.

I thank you for this opportunity to share some of my thoughts.

Mr. FARENTHOLD. Thank you very much, Mr. Deaton.

[Prepared statement of Mr. Deaton follows:]

Congressional Testimony
House Committee on Oversight and Government Reform
Subcommittee on Federal Workforce, U. S. Postal Service
and Census

Bypass Mail, A Broken System

Steven Deaton

March 4, 2014

Mr. Chairman, members of the Committee:

Thank you for allowing me this opportunity to talk about a subject that is very important to me. I am a resident of Alaska for over 50 years and have traveled to most communities within the state. My professional career started with the US Postal Service, all within the state of Alaska, for a total of 30 years. As a Network Specialist for the USPS, I managed all aspects of mail air transportation within Alaska, which included among others, managing air carrier scheduled performance and reliability and ensuring bypass mail shipper participation and policy compliance.

In 2011, the USPS offered an early-out retirement package to management personnel, which I accepted, along with several of my peers and supervisors. While I am currently the Senior Vice President at Alaska Central Express (ACE Air Cargo), an Alaskan passenger charter and freight airline, I am still intimately involved in the transportation of mail within Alaska, including bypass mail.

I come to speak to you today based more on my experience with the USPS and the Alaskan aviation industry than as an active representative of an Alaskan airline.

The State of Alaska is unique. It is the largest state in the United States in land area at 586,412 square miles, over twice the size of Texas, the next largest state. Counting territorial waters, Alaska is larger than the combined area of the next three largest states: Texas, California and Montana. It is also larger than the combined area of the 22 smallest U.S. states. It has a longer coastline than all the other U.S. States combined. There are over three million lakes. Marshlands and wetland permafrost

cover 188,320 square miles. The capital city, Juneau, is situated on the North American continent, but is not connected by road to the rest of the North American highway system. Accessibility was and is only available by air.

This presents a huge logistical problem for the USPS. Bulk subsistence type products had to be shipped through air transportation. The products were delivered to the main USPS distribution facilities in Anchorage and Fairbanks to be inducted, sorted and then delivered to air carriers for transportation. The USPS facilities and staffing were inadequate to handle the millions of pounds bulk mail that was being processed weekly.

In this unique location where there are no roads to over 200 hub and rural communities, the USPS needed to develop a program to move bulk subsistence type products by air due to a lack of infrastructure and personnel both at origin and destination. Growing bulk mail volumes overwhelmed the facilities in Anchorage and Fairbanks as well as at the small one room Post Offices in the rural communities. In order to meet this service need, with the support of U.S. Senator Ted Stevens, we implemented the "Bethel Experiment". It was a pilot program that intended to reduce the congestion and the costs to the USPS. The program had authorized bypass mail shippers delivering the mail directly to a qualified air carrier who then transported this bulk mail to a hub for delivery by them to the addressee or to a secondary bush carrier for final delivery to the destination community. All aspects of the transportation, transfer and delivery to addressee were the responsibility of the air carrier. These carriers were paid a rate periodically set by the US Department of Transportation based on reported air carrier costs.

Based on my years of experience with the movement of mail within the State and the unique challenges in doing so, it is my opinion that one would be hard pressed to devise a better or more efficient system for moving millions of pounds of subsistence type product to rural communities where no roads exist and the socioeconomics of these communities are largely sustained by either federal or state subsidy programs. However, providing this needed mail service comes at a considerable cost and at a loss to the Postal Service.. The postage rates set for bulk type mail that is transported more cheaply via surface transportation in the lower 48 States, simply do not cover the higher air transportation costs that the USPS incurs within Alaska. One could debate whether it is appropriate for the USPS to subsidize through postage rates the cost of those living in rural Alaska. However, it is beyond argument that the USPS accomplishes the transportation of its mail products across vast distances within the largest State of the union in a highly efficient manner.

It is important for the Committee to know the history of the aviation industry that transports bypass mail in considering its future. During the late 80's/early 90's, the Alaskan aviation industry consisted of approximately 35 air carriers, with the majority

consisting of small carriers operating to bush communities. These were not the large mainline carriers that transport large bypass volumes out of the Anchorage and Fairbanks origin points, but were the carriers that transported bypass mail from the hubs to the final village community using small aircraft that had to make multiple trips to move all of the mail. During this period it was quite common for there to be one or two passenger carriers serving bush villages along with six or seven all cargo carriers. The all-cargo carriers would file a schedule with the USPS but would only fly on the days that they received mail tender from the Postal Service, usually bypass mail. This resulted in full service passenger, cargo and mail carriers having to split the mail with these "cherry picking" cargo carriers who only flew mail. The results were higher passenger ticket costs for interior Alaskans due to passenger carriers not having an efficient mix of passenger and freight/mail revenue to cover the high cost of their services.

Fast forward to the early 2000's and we found ourselves with a bush aviation industry in Alaska that was economically distressed due to the perverse incentives driving cargo carriers to compete for the carriage of bypass mail. When the Rural Service Improvement Act of 2002 (RSIA) was being drafted, the most important goal was to establish and stabilize the bush passenger, freight and mail transportation system for the residents of rural Alaska. Some thought that to achieve this objective it was necessary to include in the bill a provision to block the entry of new mainline air carriers other than the ones that were currently in place at the time. At the time the USPS expressed its objection to this provision as unnecessary and not good public policy. As a USPS representative, I met with Senator Stevens and his staff to provide the views of the Postal Service as to the likely effects of the legislation. Of course, incumbent mainline carriers favored such a provision as it would limit competition. The USPS was able to offset, but only in part, the proposed preference for mainline carriers. Hence, in the final bill mainline competition was limited as proposed and passenger air carriers, at the bush level, were given the lion's share of the mail to transport via the "pool concept" in line with the objective of preserving passenger service to bush communities. The statutory pool concept required the USPS to tender 75% of the mail to passenger carriers and only 25% of the mail to freight only carriers. This was in spite of the fact that under this federally regulated environment, mail was loaded only after passengers and their bags were enplaned. The result forced the USPS to tender the majority of the mail to those air carriers with the least amount of capacity to transport it. However, the RSIA did achieve the objective of reducing the number of carriers conducting bush operations thereby providing the remaining carriers a more stable source of revenue. From over 30 small bush air carriers, there remain today a total of 9 small bush air carriers still transporting bypass mail.

Unfortunately, while the pool concept has narrowed the number of bypass mail carriers, the result is having an unintended, negative effect on USPS costs. A recent study commissioned by the State of Alaska, Department of Transportation, Statewide Aviation, identified the fact that bush carriers are now flying less efficiently due to the RSIA requirements for remaining qualified to participate in the passenger pool—and its 75% set aside. During interviews with bush air carriers, the firm Northern Economics (commissioned to produce the report) was told by air carrier interviewees that passenger carriers fly more frequently than they are scheduled in order to keep their passenger traffic numbers high, to remain qualified to participate in the movement of no less than 75% of the mail. This inefficient activity results in lower passenger load factors being reported to the US DOT and resultant higher rates being set by the DOT that the USPS has to pay to transport mail. (Note the DOT set rates paid to air carriers is entirely independent of the postal rates paid by the postal patron). USPS payments to Alaska carriers currently results in a loss of approximately \$100 million on an annual basis and the majority of the loss is attributable to the RSIA “pool concept” that dictates to the Postal Service the requirement to tender mail to those carriers with a bypass mail preference at increasingly higher DOT set rates.

Another component of RSIA that hinders competition by restricting the USPS from utilizing bush air carriers is the restrictions on using the DOT “rate equalization” policies that allow air carriers to equalize the rate of their pay to a lower one in the market. As an example, allowing composite rate equalizations, where a carrier flies direct from an acceptance point to a bush community would not only improve mail/passenger/freight service to residents of Alaska, but it would also bring an immediate savings to the USPS. This is accomplished by the USPS paying one less terminal handling fee to the air carrier than they would normally pay for service provided through the assigned hub. Allowing utilization of the DOT equalization policies brings immediate savings to the Postal Service.

Where are we today?

It is my opinion that the Alaska Bypass Mail system is not significantly broken although it is in need of some repair. The number of air carrier participants, both mainline and bush, in the Alaskan aviation industry has been reduced as intended by the RSIA. Those that remain are long established and have a wealth of experience flying in Alaska’s harsh operating environment. The large numbers are gone, the mail only carriers no longer exist which is all to the good. The entry barriers in RSIA effectively restrict new competition except to those already established in Alaska. The Committee finds itself with an opportunity to amend RSIA in a way to ensure that bypass mail continues to provide the residents of rural Alaska the subsistence type

products that we take for granted in the lower 48, while at the same time fostering a more efficient Alaska transportation system based on competitive principles and doing so at lower costs for the Postal Service.

How do we do that?

Leaving the existing barriers to entry in place, while eliminating the pool concept will allow for more Alaskan air carriers to engage in the transportation of bypass mail. This will not only provide better service to the residents of rural Alaska, but it will also ensure higher and more efficient load factors for all carriers, not just a few. This will also allow for more efficient flight and passenger scheduling by full service carriers; those efficiencies resulting in a downward pressure on the DOT set mail rates.

Allowing for equalizations is an easy fix and simple to understand. By removing a terminal handling fee for every pound of mail transported in a market, over the existing cost being paid by the Postal Service, will bring immediate savings.

Lastly, I respectfully propose that you consider making these changes to RSIA not only to preserve the bypass mail system for rural Alaskan residents and to reduce USPS losses, but also to correct the imbalances created by the sections of RSIA that favored a few carriers at the expense of competition and the public interest but that are now increasing the cost of the Postal Service when providing bypass mail service.

Mr. FARENTHOLD. We will now hear from the vice president of customer service of airports and cargo for Alaska Airlines, Mr. Jeff Butler.

STATEMENT OF JEFFREY BUTLER

Mr. BUTLER. Good afternoon, Chairman Issa, Ranking Member Cummings, Chairman Farenthold. My name is Jeff Butler, and I do serve as the vice president of customer service, airports, and cargo and reservations for Alaska Airlines, and I am genuinely appreciative of the opportunity to testify today on the importance of the Bypass mail system to the State of Alaska.

It's been interesting listening to the deficit conversation thus far this morning because I agree with Mr. Deaton, 75 percent of that issue really is between the hub locations and the bush, not mainline, which has been the testimony thus far and the crux of this bill.

Nonetheless, the vital importance of this program really can be summarized in one sentence: It provides rural Alaskans with access to fresh food and basic supplies which otherwise they could not afford to pay if they had to pay higher air freight prices. Statements to this subcommittee by the Yukon-Kuskokwim Health Corporation, the mayor of the North Slope Borough, and other native organizations confirm the dire consequences in these remote communities if there are changes to the Bypass mail system.

Alaska Airlines, the largest air carrier in the State of Alaska, has been a significant mainline Bypass carrier and respectfully disagrees with H.R. 4011. That legislation could create negative effects among all of the mainline Bypass carriers' stakeholders, most importantly the residents of the State's most isolated villages and regional communities, as well as the United States Postal Service and the existing Bypass mail carriers.

The only beneficiaries of H.R. 4011 would be the three or so new entrant Bypass mail carriers that the legislation would make eligible. It would transform the entire Bypass mail system and lead to reduced Bypass mail and passenger service levels. It would jeopardize the rural communities' fragile transportation infrastructure and drive the United States postal costs even higher.

The economic reality is that the Bypass mail market has been shrinking because of out migration from the rural communities and other recent changes in the program itself. Alaska Airlines' January 2014 Bypass mail volumes were 13 percent lower than January, 1 year ago. The resulting reduction in revenue is already straining the ability to maintain the level of regularly scheduled mail, freight, and passenger service we have long operated to rural communities. The significant Bypass mail revenue diversion resulting from additional new Bypass mail carriers would almost certainly oblige Alaska to materially reduce the level of both its passenger as well as Bypass mail service within the rural communities. The Alaska native organizations emphasize the serious negative effects on the rural communities from such service reductions.

We strongly encourage this subcommittee to bear in mind that an important objective of the 2002 Rural Services Improvement Act expressly provided that the use of the Bypass mail system be used to support passenger as well as mail service to the isolated rural

communities. Operating Bypass service is costly. The towns do not maintain their own airport terminals like most of the lower 48. In Nome, Kotzebue, Barrow, Bethel, Alaska Airlines built those terminals. Alaska Airlines maintains those terminals on both the passenger, cargo, and mail facilities.

These are really small towns of 2,000 to 4,000 residents serving even smaller outlying villages. The resulting economic challenges of operating to these communities long ago established a clear need for a program like Bypass mail.

The suggestion that the system is broken that we spoke of earlier and would somehow benefit with the addition of more carriers just simply does not comport with the facts. The Bypass mail market is not a typical aviation market which positively responds to the addition of new carriers. It is a market that is declining, and there appear to be few prospects for meaningful growth.

There is no possibility of market growth from price stimulation. Parcel post rates are set by the USPS with the approval of the Postal Rates Commission. It is these parcel post rates that the shippers pay directly to the United States Postal Service and which the rural residents then indirectly pay in the form of commodity prices. With a flat to declining market and price uniformity, the addition of three or so new Bypass mail carriers could only lead to one result, the decrease in each of the four Bypass mail carriers' approximate market share from 25 percent to just 14. That substantial Bypass mail reduction has to translate into reduced levels of Alaska Airlines' passenger and freight service, in addition to reduced Bypass mail service among the four existing mainline Bypass carriers.

The United States Postal Service would also experience significantly worse financial results if new operators of smaller, less efficient aircraft became Bypass mail participants. Those negative results would directly flow from the application of the DOT's long-standing rate-making formula establishing the rates the USPS must pay the Bypass mail carriers for transporting mail.

The proliferation of new entrants' smaller, less efficient aircraft would unquestionably increase flying costs. The magnitude of that substantial increase is apparent. A simple comparison of the flying capacity unit cost of Era Aviation, one of the prospective new entrants, and the same cost of Alaska Airlines shows that Era's available ton mile cost for its smaller propeller aircraft is \$1.92, in sharp contrast to Alaska's Boeing 737 ton mile cost of just 57 cents, a 236 percent spread.

The fixed warehouse cost component would also increase because of the corresponding reduction in each carrier's Bypass mail volume. Under DOT's formula, warehouse costs are computed on the basis of the number of tons of Bypass mail each carrier transports. A 42 percent reduction in per carrier Bypass mail volume means that the same fixed warehouse costs have to be spread over far fewer tons, thus driving up the per ton warehouse-related expenses. The result will only further weaken USPS' financial condition.

So on behalf of the people of rural Alaska, we urge this subcommittee to not advance H.R. 4011. Thank you.

Mr. FARENTHOLD. Thank you very much.

[Prepared statement of Mr. Butler follows:]



Testimony of Jeffrey Butler
Vice President, Airport Operations and Customer Service
Alaska Airlines

Before the
Subcommittee on Federal Workforce,
U.S. Postal Service and the Census

United States House of Representatives

Alaska Bypass Mail
H.R. 4011

March 4, 2014

Chairman Farenthold, Ranking Member Lynch, and Members of the Subcommittee. My name is Jeff Butler. I am the Vice President of Airport Operations and Customer Service for Alaska Airlines. In that capacity, I oversee the airline's airport operations, cargo, reservations and customer divisions, including more than 5,000 employees and contractors in 58 cities. I am proud to say I have spent my entire career, now spanning 30 years, at Alaska Airlines. We are appreciative to have this opportunity to testify today on the importance of the Bypass Mail Program in the state of Alaska.

The vital importance of the Bypass Mail Program can be summarized in one sentence---

The Alaska Bypass Mail program "... provides rural Alaskans with access to fresh food and basic supplies which they otherwise could not afford to access if they had to pay higher air freight prices." *Northern Economics Bypass Mail Study for the State of Alaska, Final Report, March 2013, p. ES-1*

The statements of the Yukon-Kuskokwim Health Corporation, representing 30,000 rural Alaskan users of the Bypass Mail system, and of the Mayor of the North Slope Borough, bring the dire consequences of changing the system into even sharper focus—

The importance of maintaining a stable level of Bypass Mail and passenger service cannot be overstated. Our commodity prices are already among the highest in the country. We understand that the proposed changes are likely to lead to higher costs for the USPS. We cannot afford any changes likely to lead to higher parcel post rates which the wholesale shippers in Anchorage and Fairbanks would pass on in the form of even higher commodity prices. *Subcommittee Statement of the Yukon-Kuskokwim Health Corporation on H.R. 4011, dated Feb. 28, 2014*

The bypass mail service helps ensure our residents have regular passenger service so we can travel for medical emergencies and business or personal trips; amenities taken for granted by most Americans. It's not an exaggeration when I say, the combination of bypass mail service and passenger service work in tandem to ensure the very survival of the people I represent. *Subcommittee Statement of the Honorable Charlotte Brower, Mayor of the North Slope Borough, dated March 1, 2014*

Rural Alaskan residents regularly have to overcome a multitude of financial, climatic and other challenges. The last thing these residents need is for their transportation pipeline to be changed so that foodstuffs and other daily necessities, already significantly more expensive than what you and I would pay in this part of the country, are simply no longer affordable.

Alaska Airlines, the largest airline within Alaska, has been a significant carrier of mainline Bypass Mail while serving as the state's principal passenger carrier. Alaska respectfully disagrees with H.R. 4011 which this subcommittee recently approved. That legislation would create multiple negative effects among all of the Bypass Mail system

stakeholders – most importantly the residents of the State’s many isolated villages and regional communities, as well as the USPS, and the existing bypass mail carriers. The only beneficiaries of H.R. 4011 would be the 3 or so new entrant Bypass Mail carriers the legislation would make eligible for the carriage of mainline Bypass Mail. H.R. 4011 would transform the entire Bypass Mail system and, in the process, lead to reduced Bypass Mail and passenger service levels, jeopardize the rural communities’ fragile transportation infrastructure and drive the USPS’ costs higher – at the same time Congress has been working to find ways to improve the USPS’ financial condition.

Alaska Airlines’ Bypass Mail operation currently consists of almost 80 weekly flights between Anchorage and Fairbanks to regional hub communities including Bethel, Barrow, Nome and Kotzebue. Most of those flights are operated with “combi” aircraft – Boeing 737s specially configured to accommodate both Bypass Mail and passengers. Alaska regularly uses more than 135,000 sq ft of terminal/warehouse space at its Alaskan locations to accommodate Bypass Mail. Bypass Mail primarily consists of foodstuffs including perishables, medical supplies and the other daily necessities on which the people of rural, roadless Alaska rely. The Bypass Mail system has long been the primary transportation pipeline used by the rural grocery stores, hospitals, medical clinics and trading posts. The position statements being submitted by various Alaska Native organizations and the regional communities clearly attest to the importance of the Bypass Mail system and the reliance of the regional residents and isolated communities on a stable network of regularly scheduled Bypass Mail as well as passenger service.

The economic reality is that the Bypass Mail market has been shrinking because of out migration from the rural communities and other recent changes in the Bypass Mail system. Alaska Airlines’ January 2014 Bypass Mail volume was 13% lower than our January 2013 Bypass Mail volume. The resulting reduction in Bypass Mail revenue is already straining Alaska’s ability to maintain the level of regularly scheduled mail, freight and passenger service we have long operated to the rural communities. The significant Bypass Mail revenue diversion resulting from the addition of 3 or so new Bypass Mail carriers would almost certainly oblige Alaska to materially reduce the level of both its passenger as well Bypass Mail service to rural Alaska. The consequences of the passenger service reduction would surely have serious negative effects on the rural communities—which is uniformly the view of the many Alaska Native organization submissions to this Subcommittee.

We strongly encourage this Subcommittee to bear in mind that an important objective of the 2002 Rural Services Improvement Act expressly provided that the use of Bypass Mail revenues are to be used to support passenger, as well as mail, service to the isolated rural communities. Alaska Airlines serves 19 communities in the state of Alaska. Only 3 communities are connected to any sort of road system. We are the interstate highway system in Alaska. For each of the isolated communities that are part of the bypass mail system, Alaska Airlines offers the only mainline jet service to these small towns. We are the lifeline for these communities. Nome offers a compelling example. The community will celebrate the annual running of the Iditarod sled dog race this month which commemorates the 1925 dog sled relay that brought critical serum to the community

which was suffering a diphtheria epidemic. Almost 90 years later, access to this Bering Sea community is still severely challenged and, without the 3 daily arrivals by Alaska Airlines, it may still be reliant on dog sleds to bring needed supplies to town.

This service, however, is costly. The significant distances between the urban centers of Anchorage and Fairbanks and the bypass mail towns in northern and western Alaska argue for jet service. Yet operating jets into these small communities brings with it unique expenses. For instance, the towns do not maintain their own airport terminal buildings as we see in most of the United States. In Nome, Kotzebue, Barrow and Bethel, Alaska Airlines has built and maintains the passenger/cargo/mail terminal buildings. These are small towns with 2000-4000 residents, serving even smaller outlying villages. While air service is essential there is only so much demand. The resulting economic challenges of operating to these communities long ago established a clear need for a program like bypass mail.

The suggestion that the Bypass Mail system is broken and would somehow benefit from the addition of 3 or so additional carriers simply does not comport with the facts. The Bypass Mail market is not the typical aviation market which positively responds to the addition of new carriers. We have already explained that the Bypass Mail market is a declining market and there appear to be few prospects for meaningful growth. There is no possibility of market growth from price stimulation. Uniform Parcel Post rates are set by the USPS with the approval of the Postal Rates Commission. Every shipper pays the same Parcel Post rate within the same shipment size category. It is these Parcel Post rates that the shippers pay directly to the USPS and which the rural residents then indirectly pay in the form of commodity prices. With a flat to declining market and price uniformity, the addition of 3 or so new Bypass Mail carriers will only lead to one result—the decrease in each of the 4 Bypass Mail carrier's approximate market share from 25% to just 14%. That substantial Bypass Mail revenue reduction has to translate into reduced levels of Alaska's passenger and freight service—in addition to reduced Bypass Mail service among the 4 existing Bypass Mail carriers. Alaska Airlines and various Native organizations have already highlighted the negative consequences of such service reductions.

The USPS would also experience significantly worse financial results if the 3 or so new operators of smaller less efficient aircraft became Bypass Mail participants. Those negative results would directly flow from the application of DOT's longstanding ratemaking formula establishing the rates the USPS must pay the Bypass Mail carriers for transporting mail. Both mail rate components—the variable costs which correspond to flying costs and the fixed costs which relate to warehouse expenses—would escalate. The proliferation of the new entrants' smaller less efficient aircraft would unquestionably increase flying costs. The magnitude of that substantial increase is apparent from a simple comparison of the flying capacity unit costs of Era, one of the prospective new entrants, and the same cost for Alaska. The most recent DOT ratemaking order states that Era's available ton-mile cost for its smaller propeller aircraft is \$1.92 in sharp contrast to Alaska's Boeing 737 available ton-mile cost of just \$.57. DOT Order 2013-12-3, dated Dec 6, 2013, App D. The 236% spread between the unit costs of the other prospective

entrants is almost certainly similar. The fixed warehouse cost component would also increase because of the corresponding reduction in each carrier's Bypass Mail volume. Under DOT's formula, warehouse costs are computed on the basis of the number of tons of Bypass Mail each carrier transports. A 42% reduction in per carrier Bypass Mail volume (from a 25% to a 14% market share) means that the same fixed warehouse costs will have to be spread over far fewer tons—thus driving up the per ton warehouse-related costs. The combined increase in flying and warehouse costs would only make the USPS' weakened financial condition far worse—and negate the benefits of other structural USPS reform changes Congress is considering.

The bypass mail program serves an area of the United States that is economically depressed and has serious limited infrastructure. The Americans that live in these communities – many of whom are Alaska Natives and have lived in the region for generations – live and work in often harsh conditions. They can't get in their cars and drive to medical appointments in the city. They don't wait for the train or semi-truck to arrive with reasonably priced basic commodities for their stores. But they nonetheless love this country, they're proud Americans and proud Alaskans and they deserve, and are incredibly reliant on, what is already an established but fragile transportation infrastructure. On behalf of the people of Nome, Kotzebue and the other affected towns, we urge this Subcommittee to not weaken this system further by advancing H.R. 4011. Please do not allow this bill to move forward.

Thank you. I am pleased to answer any questions from the Subcommittee.

Mr. FARENTHOLD. To express my gratitude for everybody for their testimony. We'll now take a few moments for questions. I'll start out by recognizing myself for 5 minutes. And I'd like to say up front, I really do appreciate this group enlightening this committee, and me in particular. The last time I was in Alaska was 5 years before I was elected to Congress, and I was much more interested in where the salmon were biting than how the mail and goods got delivered to rural areas.

I'd like to start with Mr. Haberman. I'm going to take the 30,000-foot view of this. This Bypass mail system is something that's completely different than the Postal Service offers anywhere else. Our idea of universal service is you get your bills, you get your catalogs, and you get your packages delivered anywhere in the U.S., and there's a 70-pound limit on what the Postal Service will deliver through the regular mail. Is that correct?

Mr. HABERMAN. Yes, sir.

Mr. FARENTHOLD. And Bypass mail is only available in Alaska. And would you say it's more akin to something like a truck line or a freight company or even an air freight company like, you know, FedEx or Atlas or somebody might do?

Mr. HABERMAN. Well, Mr. Chairman, I think it's important to remember that, even though it's called Bypass, it is mail. The pieces in those pallets that you see have to be prepared per our DMM regulations.

Mr. FARENTHOLD. Right, but we could say we are not going to play this game anymore and Alaska would have no different service than everybody else from the mail system if we completely got out of Bypass mail. This is something special we are doing for Alaska.

If I were to walk into the post office with that, I couldn't mail it from Corpus Christi to Washington.

Mr. HABERMAN. That is correct, sir, but you have to remember that each one of those individual pieces you could mail, and those were the pieces that were in the parcel post lines going through the postal infrastructure prior to Bypass mail. They are simply combined on the pallets for ease of transportation.

Mr. FARENTHOLD. Right. All right, so 40 years ago there might not have been as many options for getting that. But we're getting away from it. I just wanted to make sure we were clear that this is something that's unique to Alaska. We don't offer it in Hawaii, where it's difficult to get from island to island, or to Guam. It's only within Alaska.

Mr. HABERMAN. Bypass mail service, yes, sir.

Mr. FARENTHOLD. Okay.

Let me go to Mr. Devany from the Department of Transportation. You guys set these rates for this. I mean, you all used to set rates for passenger air travel. It was all regulated. What happened when you all quit regulating that? Did rates go down and lots of new service come up and good things generally happened? Microphone, please. Microphone, please, sir.

Mr. DEVANY. How do I do it. Is it on?

Okay. Yeah, I was at the Civil Aeronautics Board when airlines were deregulated. We used to tell airlines where to fly, how much to charge for passengers, how much to charge for cargo, how much

to charge for mail, and so on, and it was deregulated. They didn't just flip a switch. But intra-Alaska mail rates were unique.

Mr. FARENTHOLD. Sure. It's a statutory creation.

Mr. DEVANY. Yes.

Mr. FARENTHOLD. I get that. Part of what we've heard is that this was designed also to help out passenger service. Aren't there other programs that the Department of Transportation has to subsidize air service to remote airports?

Mr. DEVANY. Yes, there is the Essential Air Service program, which I'm also—

Mr. FARENTHOLD. Right. And so this is basically subsidizing Alaska Airlines at the expense of postal customers. So when I go buy a Forever stamp and put it on my Valentine card to my wife, a small portion of that is going to subsidize delivering Diet Coke to remote Alaska?

Mr. DEVANY. Well, I don't know.

Mr. FARENTHOLD. Okay.

Mr. DEVANY. First class mail is—

Mr. FARENTHOLD. Right. But I mean it's coming from the Postal Service.

I guess I can ask that to Ms. Whitcomb. Is that an accurate statement that, you know, one whatever of a cent of every stamp I buy goes to help subsidize this?

Ms. WHITCOMB. Right. Yes, I think it's fair.

Mr. FARENTHOLD. I'm going to just say, I think Congress, if we wanted to appropriate money for this, that's great, but do we really need to hide it within what folks do for stamps.

One of the other things we heard earlier was there was a concern about the safety of these new carriers. Mr. Devany, you're in the DOT. I mean, there's a news story whenever there's an airline accident, whether it's passenger or freight. I mean, there's usually a news story. Do we have a problem with safety of any of our carriers in this country?

Mr. DEVANY. Mr. Chairman, I don't work for FAA. I'm in DOT. Is this on.

Mr. FARENTHOLD. Yeah, it's on.

Mr. DEVANY. I still don't know how this thing works.

Mr. FARENTHOLD. Mr. Butler, you work for Alaska Airlines.

Mr. ISSA. You need to get the mic closer to you there.

Mr. DEVANY. I'm sorry. I'm not in FAA.

Mr. FARENTHOLD. I'll go to Mr. Butler. He's in the industry. I'm sure you all watch accidents for every carrier for lessons learned. I mean, do we have a safety problem anywhere within the U.S. aviation system?

Mr. BUTLER. I wouldn't necessarily say so. But I do believe that the conversation earlier this morning was more focused on the very unique climate and terrain that you do fly within the State of Alaska, and that does take a particular skill level.

Mr. FARENTHOLD. We certainly found that some of the carriers coming into Washington don't have that skill level, based on the number of flights that have been canceled over the past couple of days.

Mr. BUTLER. I think where I was headed with that was that there is certainly any number of navigation systems that are on a

lot of those airplanes that in fact our planes do have, and not all of those types of aircraft that Chairman Issa was referencing earlier have that. And all of that affects the delivery time and delivery strain or timeline of how you get—

Mr. FARENTHOLD. But I mean, if that becomes necessary, the NextGen stuff, the NTSB type stuff, they're pretty much available for any airplane. I mean, you can buy it.

Mr. BUTLER. They're not available for usage at all of the mainline airports in Alaska yet. But that's true.

Mr. FARENTHOLD. That's a problem we can deal with over on the Transportation Committee, and believe me, that's something they're working on.

I see I have already gone over time, and I will apologize to Mr. Cummings and give him an extra minute-40 for his questions.

Mr. CUMMINGS. Thank you very much, Mr. Chairman.

According to the inspector general, Congress passed the Rural Service Improvement Act of 2002 because carriers in Alaska were focusing on providing services to the Bypass routes that were the most profitable rather than on providing broad passenger service. That created the equitable tender system and gave statutory preferences to those mainline carriers providing service before January 2001. The act also set high barriers to entry to any new carriers seeking to enter the mainline market.

Mr. Haberman, just so we have the basic facts, can you quickly explain how these provisions work, what advantages do carriers that were providing Bypass service before January 2001 how over new entrants, and what are the specific conditions new entrants must meet to carry Bypass?

Mr. HABERMAN. Congressman, I think the best way to answer that is there in RSIA there are some hurdles that a carrier would have to live up to in order to enter that pool. And if I recall correctly, they are they have to provide service for 36 months in the marketplace, they also have to have a passenger load capability of 75 percent of the other carriers. Does that answer your question?

Mr. CUMMINGS. Yeah, that's a pretty high hurdle? Would you consider that a pretty high hurdle to get over?

Mr. HABERMAN. I couldn't comment on that, sir. I'm not—

Mr. CUMMINGS. All right. Well, why don't we go to the inspector general. The inspector general's white paper criticized this provision of the Rural Service Improvement Act, saying that it provided protection for the five existing mainline carriers. Ms. Whitcomb, does the IG still stand by that position?

Ms. WHITCOMB. Yes, we do

Mr. CUMMINGS. And why is that?

Ms. WHITCOMB. We believe that the situation, as it stands, results in increased cost to the Postal Service because of the limitations of the five air carriers and the hurdle that you spoke of earlier.

Mr. CUMMINGS. Well, now, the IG report is recommending changing the law to eliminate the statutory restrictions placed on new entrants to both the mainline and bush markets.

Ms. Whitcomb, is it your contention that allowing additional carriers to enter this market would drive down the cost to the Postal Service?

Ms. WHITCOMB. We believe that it would, there would be some impact to the reductions in the cost to the Postal Service. And that was one of the options, one of the suggestions in the report. We had several others as well that could be considered.

Mr. CUMMINGS. What effect might the entry of additional carriers to the Bypass market have on passenger service in Alaska, particularly with regard to the remote regions?

Ms. WHITCOMB. It's a complex system, as you know, and as we've discussed here on the panel. We talk about, I think, in the report about how the increased competition in the international rates has resulted in reduced cost, and so we were kind of looking to that as a model. But, again, it's a complex system, and this was one suggestion as a possible option to look at related to Bypass mail, Bypass.

Mr. CUMMINGS. Is it the inspector general's position that we shouldn't have a Bypass system?

Ms. WHITCOMB. I don't think we've stated that that's our position.

Mr. CUMMINGS. I'm asking you, what time do you think? I'm just curious. I mean, I understand that the system was put together because of a unique situation.

Ms. WHITCOMB. Right.

Mr. CUMMINGS. And there have been allegations earlier that the Constitution requires that we have this. Do you agree with that, some kind of system like this?

Ms. WHITCOMB. We believe universal service is an appropriate role for the Postal Service. This, though, in many cases resembles more of a freight type of service versus a mail kind of service. So that's the way that we looked at it in our paper and how we did our evaluation.

Mr. CUMMINGS. Go ahead.

Ms. WHITCOMB. I think asking about whether we believe it's appropriate to have an Alaska Bypass at all, program at all, I'm not sure that we came down on whether that is appropriate or that we have a position on the appropriateness. We believe it serves a purpose for the citizens of Alaska, but it's evolved into a very important role in the State of Alaska. We do have many concerns, though, about the Postal Service's role in kind of subsidizing the system.

Mr. CUMMINGS. Now, You were in the room when the Senator and the Congressman testified a little bit earlier, were you not?

Ms. WHITCOMB. Yes.

Mr. CUMMINGS. Were you here?

Ms. WHITCOMB. Uh-huh.

Mr. CUMMINGS. And you heard them say that the legislation that we passed out of our committee a week or so ago, they claim that what it would do is it would cost more, a lot more. And do you agree with that? Obviously, you don't.

Ms. WHITCOMB. We have not done a thorough analysis of it. It's a very complex system, as I said. We don't believe that it would cost more. But again, I'm not certain as to what they're relying on, what numbers they're relying on to come to that conclusion.

Mr. CUMMINGS. Now, Mr. Haberman, in February 2014 the committee did consider H.R. 4011, the Alaska Bypass Fair Competition

Act of 2014. What is the Postal Service's understanding of exactly what this legislation would do?

Mr. HABERMAN. I believe the Postal Service attorneys are still looking at that legislation, sir, so I can't offer an opinion at this time.

Mr. CUMMINGS. Well, is the Postal Service aware of air carriers that are seeking to enter the Bypass market?

Mr. HABERMAN. We believe there are some carriers that would like to be in the Bypass market, yes, sir.

Mr. CUMMINGS. I mean, have they approached you all? I'm just curious.

Mr. HABERMAN. They have talked to some of our representatives in the Alaska District. I don't know who they are specifically.

Mr. CUMMINGS. And could the carrier or carriers meet the 36-month performance standard?

Mr. HABERMAN. I can't answer that, sir. I can certainly go back and verify that and provide an answer for the record.

Mr. CUMMINGS. And, Mr. Butler, what is Alaska Air's position on H.R. 4011?

Mr. BUTLER. As I stated earlier—

Mr. CUMMINGS. Keep your voice up, please.

Mr. BUTLER. Yes. As I stated earlier, we disagree with it. And I think Mr. Haberman's paper that he submitted in advance where it says this is the most cost-effective process and program there is, is our opinion. It works today.

Mr. CUMMINGS. And, Mr. Deaton, what is ACE Air's position on the legislation?

Mr. DEATON. ACE believes that there are sufficient barriers in entry to intra-Alaska Bypass mail transportation, other than requiring 36 months or having a 12/1/2001 date. The requirement is 12 months service, not 36 months service between any two points within the State of Alaska, and there is also a requirement of performing that 12 months with equipment of the size, either mainline or bush, that you're going to be continuing once you qualify for.

Those hurdles, along with the certification process by the FAA, are extremely strenuous both from a certification and regulatory process, as well as from an economic process, because even once a mainline carrier gets past its 12-month hurdle of intra-Alaska service, which was written in there specifically to give it the experience from a safety standpoint of flying within Alaska, that carrier then needs to provide 75 percent of the seats in whatever market it's determined it wants to begin carrying passengers in for matching 75 percent of the ensured seats offered by the incumbent. That economic barrier, in addition to 12 months of flying within the State of Alaska, make it extremely difficult, and to my knowledge there are no mainline carriers that are seeking Bypass mail entry.

Mr. CUMMINGS. Thank you very much.

Mr. FARENTHOLD. Thank you, Mr. Cummings.

We'll now go to the chairman of the full committee, the gentleman from California, Mr. Issa.

Mr. ISSA. Thank you.

There has been a lot of talk about killing Bypass mail, as though there's anything in either of these bills that intends to do it. Mr. Haberman, you talked about this being the most efficient system.

What does that have to do with this legislation? Aren't we attempting to make this system more efficient? In other words, you contrast, in your opening statement seemingly parcel post or the post office getting involved in this delivery versus not getting involved. Nothing in this legislation puts the postal system back into the picture, does it?

Mr. HABERMAN. Not that I'm aware of, sir.

Mr. ISSA. So I was a little perplexed, because from a postal standpoint you simply take the bill that Mr. Devany gives you indirectly and pay it. You collect a fraction of the revenues that it takes to operate it, so you collect \$36 million and you pay out \$100-and-some million. That's really all you're doing, right?

Mr. HABERMAN. That's the way the system is.

Mr. ISSA. Okay. So you're calling this an efficient system, and I'm a little perplexed that you're calling it an efficient system.

Mr. Devany, when you look at the cost of the various carriers, do the cost of operation of the various carriers vary?

Mr. DEVANY. Yes, Mr. Chairman, they do.

Mr. ISSA. Okay.

Mr. DEVANY. And what we do—

Mr. ISSA. Well, let's just go through real quickly, because I want to allow a lot of time for you to answer, but I'm looking at revenue ton prices. You pay Alaska Airline, from what I can tell, \$2.13 or \$2.14 per ton mile as of March 4, 2014, because they're a mainline nonpriority Bypass carrier, I believe. Mainline priority, you would pay them \$3.53 per ton mile. A bush pilot under Part 121, which is a scheduled airline bush pilot, you pay \$5.74 a ton mile, and then a Part 135 you pay \$14, almost \$15 a ton mile. And a bush seaplane—now, I suspect that these guys don't have advanced equipment and fancy terminals when they land on the lake or the ice—you pay \$32.59 per ton mile. Those figures sound familiar?

Mr. DEVANY. Yes, sir. Yes, Mr. Chairman.

Mr. ISSA. Okay. So you've got all kinds of levels of efficiency in Alaska. Isn't that true?

Mr. DEVANY. Yes.

Mr. ISSA. Additionally, if I take a bush pilot, every time that bush pilot makes a terminal stop you pay him \$850 per ton that he's carrying. Is there any way that you can see that we could save money? For example, if they made less stops at terminals, wouldn't you save \$850 per ton on a bush pilot?

Mr. DEVANY. Well, Mr. Chairman, the DOT is responsible for setting what we believe are the best fair and reasonable rates. It costs more to operate seaplanes than big planes on a per unit basis.

Mr. ISSA. Right.

Mr. DEVANY. Because there's salt and whatnot.

Mr. ISSA. So you take what actually occurs and you measure it, right?

Mr. DEVANY. Yes, sir.

Mr. ISSA. And if somebody were to come in, I don't know what it is, let's just say with an Embraer small jet, freight only, and they could do it for less money than a 737, I'm not saying they would, but if they could, you would measure a lower amount of cost and put that into your rate calculations, right?

Mr. DEVANY. That's exactly correct, sir. What we do is we set—and I don't want to get too technical here—but we set what is called a class rate. We take the mainline, for example, there's a mainline class rate, and there's four or five airlines, we put all the cost into the pot, divide it by all the units, and we say, okay, it's X dollars per ton and X dollars per mile that you fly the mail.

Now, if your costs are above average, you're not going to make out so well. If your costs are below the average, you're going to make out fairly well, and that's the whole concept of a class rate.

Mr. ISSA. So with the current rating system if you let three additional—300 additional—doesn't matter—amount of competitors in, the only way it would drive up price is if those competitors came in and were less efficient, right?

Mr. DEVANY. Yes, I think, is the answer. It gets a little more complicated, Mr. Chairman, because then you get into equalization and bush rates and so on. But, yes, I mean, if you're going to introduce someone who has higher unit costs, that would raise the cost for the entire class.

Mr. ISSA. Okay. So I think going back to Ms. Whitcomb's report, the report that the IG gave us, it sounds like—and we're doing legislation and it's early on to a certain extent. We've got a long time to go to pass the bill, pass it out of the full House, get with the Senate, conference it, it appears as though the Senator from Alaska could have comments.

But, Mr. Deaton, let me go through a couple of the things that you've seen in the way of efficiencies. If we were to allow the post office to look for efficiencies, in consultation with Department of Transportation's numbers, and then make selection on all carriers based not on a bid rate, so to speak, but based on a bid rate based on efficiency, thus choosing more efficient carriers or more efficient routes, in your opinion, would that save us money? You have 25 years of watching the system. Could we use systems like that, empower the post office to save money by making the network more efficient?

Mr. DEATON. Are you referring to moving the environment from regulated tender to actual contract bid?

Mr. ISSA. Well, contract bid is certainly something that I envision as a lower 48 person. But even if we accepted for a moment this theory that you have so many people who all get access to pick up the freight, but you pay them based on a calculation of average cost, is it possible to drive down average cost by getting more efficient carriers, meaning that the carrier gets the same rate?

I mean, you're with ACE, next to you is Alaska. If you try to compete with Alaska with your aircraft, my assumption is that if they pay you the same as they pay Alaska for the same route, you wouldn't make money, or you certainly wouldn't make what they make. Is that right.

Mr. DEATON. That's correct.

Mr. ISSA. Okay. So by definition you're only going to want to pick up freight if you can be competitive and you have a reason to be below the average against other carriers you're competing with, right?

Mr. DEATON. Correct.

Mr. ISSA. So now the question goes back, and this goes back to—and I'll go to the IG—when the IG looked at the inefficiencies and the ability to fix this, my understanding is what they wanted to see was the opportunity to look for cost savings. Now, Alaska Air is here, and you, without a doubt, with your 737 mixed cargo, if that cargo plane is full, you have the most efficient carrying capability, and actually both ways because you carry salmon back and so on.

The real question is, are we picking all the most efficient carriers for each route and then routing in the most efficient fashion? Mr. Deaton, you've operated there for longer than some people on the dais have been alive. Are we doing it as efficiently as we could or can we increase efficiency, thus causing Mr. Devany the ability to calculate a lower rate as a result of efficiencies?

Mr. DEATON. I believe that could be accomplished, Mr. Chairman. I think it's first important to understand, to separate out mainline efficiencies from bush efficiencies.

Mr. ISSA. And that's been made abundantly clear that we are dealing with three to four different submarkets, Anchorage to Bethel, you know. I've been to those places. They have big runways, big aircraft land. To be honest, the State capital may be a small, isolated place, but it has a big runway.

Mr. DEATON. That's correct. Alaska Airlines is the predominant passenger carrier on the mainline side. There are two other passenger carriers. But it's important to understand that the mainline tender of Bypass mail is a straight equitable tender. All the carriers that are qualified and are in markets receive an equitable or equal share of mail. This allows them to maximize their flight schedules, their combi versus full passenger versus all cargo, and is quite an efficient mix. The issue there in that mainline market becomes a factor of numbers in terms of bringing more mainline carriers in, would that be more competitive.

On the bush side, it's a different—

Mr. ISSA. But let me switch it around before you go off of that, because I'm a big fan of Alaska Air, I've flown them, frequent flier and all that. But let me ask the question. The equitable question is, if we lock out alternate carriers, which current law does, and Alaska is making money on theirs, but the other carriers are not able to have access to what is effectively lucrative freight, are we in fact putting Alaska at an advantage in the passenger and other miles? You know, the locking them out of the ability to carry that, Alaska would say, well, if they can't carry all of that mail on the mainline for the most part, then somehow prices are going up. The question is, wouldn't you end up with all three carrying the same amount of mail and adjusting their aircraft accordingly?

Mr. DEATON. I believe so, that's correct. You know, the issue of mail getting on a passenger airplane, whether it's Alaska or Era or Penair, after passengers and bags, means that the more efficient carrier, the higher carrier with the higher ridership usually carries the least amount of mail because they can't enplane it.

So that becomes transfer functions and moves around to carriers, the other passenger carriers that may not have the ridership, and they end up carrying the mail that was originally given to, for instance, Alaska Airlines. So it spreads itself out over an equitable basis based on who has the capacity, and at the mainline level it

tends to lend itself to a flow of mail that increases the efficiency of each carrier.

There's three passenger carrier, three cargo-only carrier at the mainline level. Quite frankly, in my experience and opinion, the markets, the economy in Alaska would not support anymore than those. Actually, I would argue that there's probably too many as there are. There's too many freight carriers for sure.

When you go to the bush side, the issue becomes the pool concept. If you're looking for efficiencies, to give 75 percent of the mail to those carriers with the least capacity to carry it and to restrict entry into monopoly markets because other passenger carriers can't get the ridership to enter or freight carriers cannot get enough mail to enter, it not only hurts the residents of that community from a freight and passenger standpoint, but it restricts competition. So it goes in both directions.

Mr. FARENTHOLD. I'm going to do a couple more questions. We will do a second round of questions. Chairman Issa has done a good job getting down into the bush or the weeds of this. I want to get back up to 30,000 feet, because quite a few people reading this record may not have the level of familiarity with the system that Chairman Issa has.

Mr. HABERMAN, I want to go back for a second on the history of the Bypass mail. I know in my first line of questioning I was pointing out that it was something unique to Alaska. But it was actually born to bring Postal Service costs down, if I'm not mistaken. Is that correct?

Mr. HABERMAN. Yes.

Mr. FARENTHOLD. I mean, rather than to meet the 70 pound limit, I could probably mail, to go back to my Diet Coke example, a dozen 12 packs of Diet Coke is about all you can get in 70 pounds. Well, if I am a retailer selling Diet Coke I would have to do twenty or thirty 70-pound packages of 12 packs of soft drink to get what I want, and the Postal Service would have to process each one of those individually, probably palletize them themselves, contract with an air carrier to get them there. So actually in Alaska I would imagine normal parcel post would be a huge loss leader for the post office. Is that correct?

Mr. HABERMAN. I would agree with that statement, Mr. Chairman, yes.

Mr. FARENTHOLD. So it actually does hold some of the costs down for the Postal Service. I wanted to get that side of the issue into the record.

I also wanted to ask Ms. Whitcomb, there was some testimony that the legislation we are talking about would result in a smaller market share as we let more carriers in. Couldn't what we do be crafted in such a way that we limit the number of carriers but have some competition among the carriers? So rather than having 25 Bypass carriers, we have five, but they bid for it competitively over a reasonable amount of time. Or we could create something that wouldn't flood the market and make it fail. Now, is that not correct?

Ms. WHITCOMB. Yes, I think that would be correct.

Mr. FARENTHOLD. Quite frankly, I am not sure it is the government's responsibility to protect businesses from their own stupid

mistakes, bidding on a contract that they can't keep or an industry overbuilding its capacity. A lot of times that actually results, I think, in lower costs for consumers as they look for more efficiencies and ways to do that.

So those are my personal final two 30,000-foot questions. I will now go to Mr. Cummings for a second round of questioning.

Mr. CUMMINGS. First of all, Mr. Chairman, I ask for unanimous consent to enter into the record letters from citizens and interest groups from Alaska concerning H.R. 4011 and the vitality of the Bypass Program to their community.

Mr. FARENTHOLD. Without objection, so ordered.

Mr. CUMMINGS. Mr. Devany, how often does the DOT visit Alaska and audit the carriers?

Mr. DEVANY. Typically, I think we go up about once a year. Whether it is officially what you would call an audit, I don't know.

Mr. CUMMINGS. Well, why don't you tell me what you do?

Mr. DEVANY. Okay. All airlines, whether they are Alaska Airlines or United Airlines or any airline, are required to submit data to the Department. It is called the Bureau of Transportation Statistics. They are auditable, just like your income taxes. I am not sure every single one is audited, but they are subject to audit, and the airlines have to swear and declare that the data are accurate. And we use those data to set the mail rate.

Mr. CUMMINGS. And how does the DOT ensure there is no collusion between the airlines to keep the costs high?

Mr. DEVANY. Well, again, all the data are subject to audit. It is in a different department of DOT. It is the Bureau of Transportation Statistics. They have audit checks, edit checks, and so on. The inspector general at DOT does audit carriers. I don't know what their schedule is and they probably don't want me to know what their schedule is. But it is audited.

Mr. CUMMINGS. And the purpose of the audit again is what?

Mr. DEVANY. I'm sorry, I didn't hear your question.

Mr. CUMMINGS. The purpose of the audit is what?

Mr. DEVANY. Would be to make sure that the data are accurate. And this goes far-reaching beyond Alaska mail rates. This could have to do with airline mergers, international alliances, all kinds of financial and passenger and traffic data.

Mr. CUMMINGS. At the end of fiscal year 2013, the Postal Service estimated the cost of the Bypass Program to be approximately \$108 million. Mr. Haberman, how much of the total cost of the program goes directly to the carriers?

Mr. HABERMAN. Those are the costs that go to the carriers, sir, so it would be 100 percent.

Mr. CUMMINGS. One hundred percent goes to the carriers?

Mr. HABERMAN. Yes, sir, I believe that is the correct answer.

Mr. CUMMINGS. And, Mr. Devany, can you explain to the committee what the Essential Air Service program is and can you tell us how many of the airlines participating in the Bypass Program also participate in the Essential Air Service program?

Mr. DEVANY. Yes, sir. The Essential Air Service program was created as part of the Airline Deregulation Act of 1978 to ensure that communities that receive air service under regulation would

receive it for at least 10 years after deregulation. It was extended. So that was 1978 to 1988. It has been extended a couple of times.

The current program is roughly 160 communities where we pay an airline to provide service where the community would otherwise not have any air service, roughly 160. I think it is about 117 in the lower 48 and 43 in Alaska. Our total bill is roughly \$250 million a year. In Alaska it is \$18 million, \$15 million to \$18 million. Frequently we pay a small airline to provide one or two, maybe three round trips a week to Bethel or to Juneau or to some acceptance point where people can then go to doctors appointments and get medicine and food and so on. So there is a little bit of interplay between the mail rates and the Essential Air Service program. Not a lot.

Mr. CUMMINGS. Mr. Butler, does the Alaska Airlines receive subsidies under the EAS program?

Mr. BUTLER. We do. None of the mainline Bypass markets are EAS markets.

Mr. CUMMINGS. So on average how much does it receive?

Mr. BUTLER. I do not know the answer to that question.

Mr. CUMMINGS. Can you get that to us, please?

Mr. BUTLER. I certainly can.

Mr. CUMMINGS. Very well. I yield back.

Mr. ISSA. [presiding] Mr. Devany, would you repeat the essential air subsidy in Alaska for delivering passengers to areas that otherwise wouldn't be served is how many dollars a year roughly?

Mr. DEVANY. It is 43 communities currently and it is between \$15 million and \$18 million. I can get you the precise figure—

Mr. ISSA. Okay.

Mr. DEVANY.—including Diomedes and Adak.

Mr. ISSA. So some of the same communities that the post office is losing money delivering Bypass mail to?

Mr. DEVANY. There is some overlap, I believe.

Mr. ISSA. So if there is an Essential Air Service subsidy would it be fair for this legislation to say that we are not going to subsidize passenger service for those communities? In other words, the post office should be able to pick the low bidder freight-only in those communities that are already subsidized—their passengers are subsidized by passenger?

In other words, if a freight-only carrier can underbid on a competitive basis the rate that would otherwise exist, should a freight-only carrier, Mr. Deaton, be able to bid for those lines, since obviously we are funding the passengers through another means? Because whether the Senator or the House Member Mr. Young said so, we all understand, and I understand directly from the late Ted Stevens, that this program is intended to keep passengers getting access to communities. He made it very clear when he did the legislation that he didn't like a number of companies, including the one you work for, because you were trying to game the system by not carrying passengers. I mean, I don't want to speak ill of the dead, but he understood, this was why he did it, and he told me so in no uncertain words in his own office.

So the question is for each of you, including Mr. Butler, if essential service is being paid for by the Department of Transportation providing a subsidy for passengers, is there any reason that we

shouldn't pick a less expensive carrier if they are willing to carry freight-only to those locations?

Mr. Butler, I will start with you.

Mr. BUTLER. I just want to go back to my comment before. In my world it doesn't apply because EAS is not in any of the mainline markets.

Mr. ISSA. Right. So it wouldn't affect your carrier. But do you see any reason that a freight-only carrier shouldn't be able to bid freight-only in those markets where there is a subsidy? You are not receiving a subsidy for essential service, is what you are saying, in the mainline markets.

Mr. BUTLER. I think there were other opportunities that we talked about earlier that perhaps we should explore instead. For instance, the rate-making authority, that doesn't require legislation to do that. I would prefer to go down that path before I would answer that question.

Mr. ISSA. Okay. Well, you know, one of the reasons we are having this hearing today is because in 2002 with no hearings Senator Stevens locked out future competition as a matter of statute. And today you are objecting to H.R. 4011, which simply undoes a portion of the mandate put in by the late Senator Stevens.

Mr. BUTLER. What I would also say, in that 2002 model, that the DOT and the State of Alaska and the Northern Economic Study said that the mainline Bypass mail product is more stable, more efficient than it was prior to 2002.

Mr. ISSA. Okay. The reason for that lockout had to do with people who were trying to not carry passengers. That was the reason Senator Stevens did it.

Mr. BUTLER. I understand that.

Mr. ISSA. And so I understand as a passenger carrier your preference is not to have something that might allow nonpassenger carriers to compete more effectively. But I still go back to the same point. What share of the market did you have in 2001?

Mr. BUTLER. The market in the State of Alaska is flat.

Mr. ISSA. What share of the market did you have?

Mr. BUTLER. Of the freight market?

Mr. ISSA. Freight or passenger, I will take either one. What was your passenger share in 2001, what is your passenger share today?

Mr. BUTLER. They are pretty much the same.

Mr. ISSA. What was your freight share in 2001, what is your freight share today?

Mr. BUTLER. They are pretty much the same.

Mr. ISSA. Okay. So this legislation didn't affect Alaska Air.

Mr. BUTLER. Bypass mail is dropping for us. Freight is——

Mr. ISSA. People are drinking less Diet Coke? Why is it dropping? Is it just less people living in the outer areas?

Mr. BUTLER. The volume year over year is down. The out-migration out of the rural communities, yes.

Mr. ISSA. Or in-migration into the cities?

Mr. BUTLER. Somewhat. The State of Alaska is not growing greatly.

Mr. ISSA. Right. So people are leaving rural Alaska, leaving Aleutian islands, leaving Alaskan native islands, and coming into cities where they are better served.

Mr. BUTLER. There is certainly out-migration from the bush.

Mr. ISSA. You know, they did that in the lower 48 some years ago, too.

So I guess the question is, legislation in 2002 didn't seem to do anything for you except lock out competition, but your market share is roughly where it was. Your complaint is your market is smaller, right?

Mr. BUTLER. The market share is what it is, and the interior market has never made money for Alaska Airlines.

Mr. ISSA. Okay. Do you carry mail in the lower 48?

Mr. BUTLER. Very limited. Los Angeles to Mexico, Los Angeles to Vancouver.

Mr. ISSA. So you do carry mail.

Mr. BUTLER. A limited amount.

Mr. ISSA. Do you have a monopoly on those two lines?

Mr. BUTLER. We do not.

Mr. ISSA. So you do it with a rate schedule and you do it because it makes you money.

Mr. BUTLER. Yes.

Mr. ISSA. So competition isn't the problem in those two routes. I just want to understand that you can carry to Mexico and to Vancouver and other people can carry and you are happy to take the mail and have it as part of your profit analysis.

Mr. BUTLER. My concern in the State of Alaska is all on the mainline portion, the portion that Alaska Airlines is responsible for out to the hub location.

Mr. ISSA. Okay. But if you had to bid for Bypass mail, which is freight basically, because you also bid for freight, I assume, in those aircraft. Now, Alaska Air 737-400s, which are split cargo-passenger versions, you carry mail, you carry people, you carry Bypass mail, and you carry freight.

Mr. BUTLER. You're correct.

Mr. ISSA. Okay. And you get paid, let's say, \$1 a pound for freight, you get paid \$1 a pound for Bypass mail, and you get paid whatever you get paid for your passengers, roughly. Okay.

The difference is that, Mr. Haberman, you get paid 32 cents a pound, so to speak, to carry freight that is costing you \$1.08 because of Mr. Devany's rates on a blended basis, is that right? I have got my numbers roughly right. But you have about \$32 million of income and \$108 million of outflow, and that is how you get a \$76 million loss on this program, right?

Mr. HABERMAN. Yes, Mr. Chairman, that is accurate.

Mr. ISSA. So the only thing we are dealing with is not the efficiency of the program, we will assume for a moment that the efficiency was perfect, but you are only getting paid a fraction, about 30 cents on the dollar of what it costs to do.

Mr. HABERMAN. That is correct.

Mr. ISSA. It is actually slightly less than 30, but close to 30. And I want to make sure, Mr. Devany, your testimony today is there are some ways that we could structure or allow to be structured Alaskan Bypass that would lead to your calculations being lower because of less expensive blended rates. Is that correct?

Mr. DEVANY. Mr. Chairman, we are agnostic on who should be included in the rate pool and who not. Obviously—

Mr. ISSA. No, no, I am not asking that. I am asking that you calculate it, and you said that some carriers cost less and some cost more, right?

Mr. DEVANY. Yes, sir.

Mr. ISSA. And you said under oath that if you take the less expensive carriers and you give them more and you take the more expensive carriers and you take them out, then your rate would drop on a blended basis, right?

Mr. DEVANY. I believe the blended rate would drop. There is also this equitable tender issue. So it is not like if a good restaurant opens up in your city and it is cheap and they have good food and everybody goes there. The statutes require an equitable tender. So everybody, every airline gets an equal—

Mr. ISSA. Every airline that is allowed in.

Mr. DEVANY. Yes.

Mr. ISSA. Okay. But they are locking people out, right? And they are not locking out the least efficient, they are locking out ones after a certain date of incorporation or operation, right?

Mr. DEVANY. Yeah, I believe it is 2001 or whatever it is.

Mr. ISSA. Okay. I just want to understand that the Senator and Congressman Young, they talked about how this whole system would fall apart and there would be all this inefficiency and it is going to collapse if we change anything, that it is a perfect system. Mr. Butler effectively said the same thing from Alaska Airlines, you can't change anything, it would only get worse, everything is going to cost more money.

This committee is not interested in destroying Bypass mail. We would love to find somebody else to pay for it. We would love Essential Air Service to pay for it. But given that that is not likely to happen and it is not within our jurisdiction, all we are looking for in H.R. 4011 and in follow-on legislation we are working on today is, can we enable, not Mr. Haberman but the people broadly behind him and so on at the Postal Service, to be empowered to find ways to authorize greater competition leading to greater efficiency, greater efficiency in structure leading to lower cost? If we can't, then this exercise is a lot of work for \$20 million in savings. We are hoping to be able to do that.

My question to you is, do you see carriers that are more efficient and as a result, if they were the only carriers in the world, would we have lower costs. And your answer is?

Mr. DEVANY. I mean, we would have to look at the numbers, Mr. Chairman. Yes, if their unit costs are lower, then the—

Mr. ISSA. But some carriers unit costs are lower. Okay.

Mr. DEVANY. Perhaps. I don't know.

Mr. ISSA. Right. So a process of selecting those who had the lowest unit cost, either by having them bid because they are able to do it for less or having them—for example, if we were to allow three other carriers that as a result of changing dates or the leading dates in H.R. 4011, if we were allowing them only to enter if they could show that their costs would be favorable to the pool, in other words they would be at or below the average, then contrary to Mr. Butler's statement, it actually would lower costs. Is that right?

If only people could enter who could prove that they would not be adverse to the rate pool were allowed to enter, your calculation—what was Kevin's name—your functionary, the person that works for you who actually does the calculations.

Mr. DEVANY. Yes, that is arithmetically correct.

Mr. ISSA. I wish I had had him. But I get the idea. I mean, that is one of the things in the legislation, is we don't want to open up competition to get higher prices. I am a pro-competition person because it normally leads to innovation, better products, better services, and so on. I understand aviation even in the lower 48 is more complex than just open it up, get better service. Anyone who has flown knows that deregulation wasn't all about better service.

I saw you didn't leave, Blake.

Okay, so we have established there are at least ways in which the way you calculate cost we could have a favorable result as a result of giving the post office certain guidance capability.

Mr. DEVANY. I think that could be the result. I don't know that it necessarily would be.

Mr. ISSA. Mr. Butler, would you agree that if somebody could carry freight and have a lower cost of delivering it, whether it is on the mainline or in the bush or a hydrofoil to a remote island, that we should be able to consider adding them if they are a more efficient carrier?

Mr. BUTLER. I think you absolutely want to look for efficiency. I totally agree with you on that statement.

Mr. ISSA. I keep thinking about your time in Alaska and the instability that that industry has been through, whether it be Reeve Air Aleutian, whether it be Wien, whether it be Alaska Airlines.

Mr. ISSA. Well, let me go through a little of the history—

Mr. BUTLER. The market is a bit unstable, I guess is what I am trying to say.

Mr. ISSA. Well, I understand it is not stable. The post office lost \$16 billion if calculated under GAAP last year and 5-point-some billion the way government calculates. That is a lot of money. We are doing a long hearing on a small part, but I am doing it separately because I want to be fair to the Alaskans rather than the lower 48 problems, which the President has addressed better than Congress.

But going back to parcel post, and I just want to make sure we get this in the record, Mr. Haberman, do you know when parcel post began in the United States?

Mr. HABERMAN. I don't know the date, sir. I can certainly get that for you.

Mr. ISSA. No, it is 1913. And it was in reaction to the 1887 international convention where the world began looking at the idea of transporting packages, and they worked out a convention, and the United States entered a domestic route. Prior to that time, we didn't ship freight through the post office. The post office was a letter carrier for over 100 years. So I just want to make sure that we leave that as part of the record.

I had two distinguished Members of the House and Senate in front of me and they talked about freight/package delivery as some sort of a universal entitlement. It's not. If the post office to survive is going to carry only letters and UPS and FedEx and all these

other folks have to worry about freight, that's okay. That's consistent with the Constitution and over 100 years of our—all of our Founders were dead by the time we carried the first parcel post, at least based on my calculation of their longevity.

Mr. Butler, since Alaska Airlines was nice enough to come here, let me go through a couple more things. You are in charge of freight for Alaska Airlines, right?

Mr. BUTLER. The Cargo Division reports to me, yes.

Mr. ISSA. Is the 737-400 your most efficient aircraft?

Mr. BUTLER. It is not.

Mr. ISSA. But that is the one you use in Alaska?

Mr. BUTLER. It is the one that we are currently flying in the State of Alaska.

Mr. ISSA. So when I fly Alaska in the lower 48, I fly a newer, more efficient aircraft, isn't that correct?

Mr. BUTLER. For passenger traffic, that is true.

Mr. ISSA. Okay. And Boeing, I understand you are from Seattle, they would make you a new combo aircraft, wouldn't they?

Mr. BUTLER. We are in the process of looking at that today.

Mr. ISSA. And if you bought probably a 737-800 type airframe combo you would have a cap cost, but you would have a lower cost of operation, wouldn't you?

Mr. BUTLER. That is a true statement. That airplane would not fly to all of those mainline Bypass markets, however.

Mr. ISSA. I understand there is a right plane for every runway. But, Mr. Devany, your people, if they were calculating a more efficient airplane, would in fact pay Mr. Butler and everyone else less, right?

I just want to understand that the current system rewards inefficiency to a certain extent, that if it costs more to operate, the rate goes up. And the only reason that you drive down your cost is that you want to make sure that whatever the rate is you then make money on it, right?

Mr. DEVANY. Yes, Mr. Chairman, I think that is essentially right. I analogize it to spaghetti sauce. You throw everything in there, you put in the spices and everything and stir it up, and then there is an average price. And if you can keep your costs below average, you make out fairly well; if your costs are above average, you don't make out so well.

Mr. ISSA. Right.

Mr. Butler, you would agree with that?

Mr. BUTLER. Yes.

Mr. ISSA. Okay.

Now, where else do you operate in which you operate based on that system, other than Alaska, where you get compensated based on the average cost of multiple carriers?

Mr. BUTLER. The Bypass mail products is the only one.

Mr. ISSA. The only one. Give me your biggest run. Your biggest run would be Anchorage to Fairbanks?

Mr. BUTLER. For Bypass mail?

Mr. ISSA. Yes.

Mr. BUTLER. Nome or Bethel.

Mr. ISSA. Bethel. Okay, I have taken that run. So 400 miles, Anchorage to Bethel. How many carriers carry Anchorage to Bethel.

Mr. Devany, in the pool, and you can check with your staff, in the pool that you calculate for the run Anchorage to Bethel, how many carriers are there?

Mr. DEVANY. I don't know the answer, Mr. Chairman. I can certainly get that.

Mr. ISSA. Okay. If you would give us for the record sort of a calculation of at a given time and a given span who the carriers were, A, B, C, D, I don't even care about the names, and what their average cost is so we could see the difference in the cost calculated based on people all carrying tonnage on the same route.

Mr. DEVANY. I would be happy to get that to you, Mr. Chairman.

Mr. ISSA. Okay.

Mr. Deaton, we are considering legislation that would encourage or prioritize or try to have carriers basically skip ports which are presently costing us money and try to have them go from point to point without an interim stop. Does that save money on the route?

Mr. DEATON. When authorized the Postal Service can tender mail to a composite carrier that flies direct from an acceptance point to a bush point and immediately, day in and day out, saves the terminal handling fee for every pound of mail that is tendered to that location. Consequently, also that community, the residents there, also receive direct service, better mail service, better product that goes through the Bypass mail. So all of those things are correct, yes.

Mr. ISSA. Okay. I obviously have a keen interest in this. Between the late Ted Stevens and myself I am the only one left to hold a hearing on this. I have asked a lot of questions. Do any of you have any additional closing things that you think should be made for the record? Do any of you have any additional items that we didn't ask that you want to make sure were in the record?

Mr. Deaton.

Mr. DEATON. I would just like to make sure the record reflects that there are multiple components, I think we have all established. The Rural Service Improvement Act and Bypass mail is a very complex system. I would totally agree, because I was involved in the development of the Rural Service Improvement Act, with the chairman's position on why it came about and what the purpose of it was. The role was to favor passenger carriers over all other carriers. The role was to restrict entry. The role was to award bush passenger carriers more favorable mail tender than they did others. And, quite honestly, it was aimed specifically, in the equalization portion, was aimed specifically at one carrier at the time. That carrier is a freight carrier at the time and remains so.

Your comment about efficiencies and unit costs, I would like to also get on the record that the current law requires the DOT on the bush side to only consider passenger carrier costs when it sets rates and it does not consider when it sets rates the cost and the lower unit costs of efficient freight carriers. So I would like to make sure that that is a part of the record also.

Mr. ISSA. I appreciate that.

Mr. Butler?

Mr. BUTLER. You know, my only comment is that I don't necessarily believe that the Bypass mail product requires anywhere

near the surgery that this bill particularly contemplates, nor the enormous—

Mr. ISSA. Wait a second. The bill only undoes the 2002 restrictions, as far as I know. We do have some additional legislation we are looking at, and that may be more surgery than you want. But what in 4011 was so onerous to allow additional competitors that were able to be in prior to 2001?

Mr. BUTLER. A number of the things that we talked about earlier that allow for the potential for the commodity product in the bush to go high, sky high, for one, I guess primarily that one.

Mr. ISSA. So your point on 4011 is that we should make sure that we put protections in, in the selection, that would be allowed to prevent that. In other words, the post office in consultation with Department of Transportation would be allowed to select carriers based on preventing the price from going up due to an adverse cost. Is that what you are saying?

Mr. BUTLER. No. My point is that I believe that 4011 causes a number of disruptions.

Mr. ISSA. But it certainly means that people can compete against you for mainline, right?

Mr. BUTLER. That is true.

Mr. ISSA. Is there anything you don't like about this bill other than that?

Mr. BUTLER. Well, I would suggest based upon the conversation earlier that there is an opportunity for the rate-making formula to be looked at, and that doesn't require anything related to legislation to make that happen, and that is one of the potential opportunities here.

Mr. ISSA. How would the post office affect Mr. Devany's absolute ability to look at price, set it, and then they have to pay it. You understand, they don't write a purchase order, they just write the check.

Mr. BUTLER. File a petition with the DOT.

Mr. ISSA. Okay. So you are telling me that the post office could beg the DOT to come up with a rule to change something, but there is no legislation required.

Mr. BUTLER. I think that's a potential.

Mr. ISSA. Mr. Haberman, have you been contemplating begging the ability to reduce the cost to the post office?

Mr. HABERMAN. I am not aware of any ability for us to lobby.

Mr. ISSA. Would it be reasonable that you should have been begging for years for that?

Mr. HABERMAN. Yes, sir.

Mr. ISSA. Do you think that the postmaster could get back to us and see if he has ever thought about trying to pay less?

Mr. HABERMAN. Absolutely, sir.

Mr. ISSA. I am astounded that we are only discovering that here today. But, Mr. Butler, I certainly will be working with the postal system to see if they believe there is any reasonable way that they could simply pay less. Something tells me that I wouldn't be here if it wasn't for \$76 million worth of cross-subsidy going on.

Mr. BUTLER. I believe that the DOT has routinely changed some of those parameters, but you will discover that yourself.

Mr. ISSA. Okay. Anyone else?

Mr. DEVANY. Chairman, there are provisions in statute and regulations that either party, either the Postal Service or airlines, can request to reopen—

Mr. ISSA. Have the airlines ever requested to reopen, try to get more money?

Mr. DEVANY. No, sir.

Mr. ISSA. They must be doing okay, right? They are not dissatisfied apparently.

Mr. DEVANY. In our world, Mr. Chairman, we want both sides to be mad at us. We want the post office and the airlines to be mad at us. Because if one side is happy, then maybe the rates are too high or too low. If they are both kind of unhappy—

Mr. ISSA. But your testimony today is you simply measure the world as it is. You are not in the business of creating efficiencies or even lobbying for efficiencies, isn't that correct?

Mr. DEVANY. That is correct.

Mr. ISSA. And doesn't that create an odd situation in which the post office cannot force efficiencies. You are not in the business of creating efficiencies. Mr. Butler is in the business of being efficient enough to make money, but not necessarily to drive down the cost to the post office. There is no particular incentive to him, is there?

Mr. DEVANY. It is an unusual situation where we play referee between the airlines—

Mr. ISSA. And I understand we could have called in the bush pilot that is costing us \$32 per ton per mile, plus \$850 per ton every time he lands. We oddly enough had Alaska Airlines volunteer to come here when without a doubt you are flying the most efficient aircraft, large capacity aircraft, to these large airports in Alaska. I mean, in a sense, Mr. Butler, I was a little surprised that you were worried as an incumbent that you wouldn't continue to compete successfully and have the lion's share of the load. But, you know, I still was happy to have you come here and make the case on behalf of your airline.

Mr. BUTLER. It isn't just the airline, it is the State and our commitment to the State. There is a reason why there is an Eskimo on that tail. We represent the State and the people within the State.

Mr. ISSA. Ms. Whitcomb?

Ms. WHITCOMB. The only additional comment I would like to make is that earlier, in the earlier panel, there was a reference to concerns with the report that we issued. We provided a response to the concerns that were addressed by the Alaska delegation at the time that that report was issued. So that might be of interest.

Mr. ISSA. We will make sure that is included in the record, since I suspect that you were not in agreement with their position.

Ms. WHITCOMB. Right.

Mr. ISSA. Okay. The last thing is I am going to ask each of the other potential carriers to submit statements for the record, particularly as to the allegation of safety. I am going to invite all Alaskan potential carriers of all sort, including bush pilots, to submit anything they want for the record relative to their ability to safely carry passengers. We will send a letter to the FAA asking about carriers in Alaska.

Mr. ISSA. Mr. Butler, if you have concerns about the three potential entrants to the market, if you want to tell us about their safety records and concerns that they would be unsafe for carrying Diet Cokes on the mainline, I would appreciate it.

Mr. ISSA. Those are areas that obviously our goal is not to disrupt the ability to carry freight in Alaska at an affordable rate. It is just the opposite. It is to drive down the cost, not the price but the cost, since it is being borne by the ratepayer.

If there are no other comments, I will keep the record open for 5 days for any of your comments in addition to what I had described.

Mr. ISSA. And with that, we stand adjourned.

[Whereupon, at 4:10 p.m., the subcommittee was adjourned.]

APPENDIX

MATERIAL SUBMITTED FOR THE HEARING RECORD

Chairman Darrell Issa
Opening Statement, Federal Workforce Subcommittee hearing, "Alaska Bypass Mail Delivery:
A Broken System"

The current Alaska bypass system is a carefully constructed program designed purposefully to use postal ratepayer funds to subsidize the Alaskan aviation industry. Last year alone, the Postal Service lost \$76 million.

Under this program, 1,000 pound orders of goods and commodities are sent as mail, but bypass the Postal Service entirely and, instead, are processed and delivered entirely through third-parties, largely the Alaskan air carriers.

While this system of contracting out processing and delivery of these bulk orders in a highly isolated state of Alaska makes sense, the current program is designed not to ensure the best value for the Postal Service and the rural Alaskan, but rather to protect a number of specific entrenched interests.

As a result, it's hard to tell precisely what benefit rural Alaskans receive from the program despite the current dramatic subsidy of bypass mail. In fact, a Postal Service Inspector General report stated that in small villages "the grocery prices seem to bear little relationship to the cost of getting the products there."

In one dramatic example, the Inspector General found that a bag of potato chips that cost \$4.29 in Anchorage cost \$9.99 in Bethel, despite a bypass mail shipping cost of just 35 cents.

This is particularly telling when the cost of shipping 150 pounds of goods 400 miles by UPS truck in the continental United States will cost 80 cents per pound, but that same 150 pounds will cost only 40 cents per pound to be flown 400 miles as part of the bypass program.

Importantly, that 40 cents per pound rate only covers 30 percent of the Postal Service's costs and current law is written in a dozen different ways to explicitly prohibit the Postal Service from taking even the most basic of opportunities to make the system more efficient. Most

significantly, current law has created tremendous barriers to entry into the system creating a de facto oligarchy of companies that carry bypass mail.

The Postal Service has no power to bring new competitors in, nor contract directly with the more cost-effective carriers. In fact, the Postal Service is barred from contracting directly with any carriers. Instead the Department of Transportation, in probably the last vestige of the regulated airline industry, sets formulaic rates for bypass reimbursement.

This archaic rate structure, combined with a further statutory preference toward passenger-carrying airlines, has created a passenger air travel market that contains twice the amount of excess capacity than in the rest of the continental United States.

To be clear, this excess capacity is paid for by the Postal Service, and therefore the postal ratepayer, and is a deliberate feature of the current system, it is not an accident. To help put this in perspective, the Postal Service's losses on the current bypass system could more than pay for the infamous "bridge to nowhere" every six years.

Given the Postal Service's clear mandate to operate as a self-funding entity, it is unfair to place this full burden on it. Therefore, we are here today to discuss ways to improve the current bypass system to make it more affordable to the Postal Service and ensure the full benefit of the system is passed on to the native Alaskan.

There are a number of ways we can do this. For my part, I have put forward a number of incremental reforms, most recently in H.R. 4011, but also in discussion draft legislation that I am beginning to circulate.

In addition, there are wider reforms that we can and should discuss, including reforms that give the Postal Service more direct power to contract with air carriers, as well as to find alternate sources of funding to promote passenger air travel capacity in Alaska, including as part of an appropriation.

In closing, I'd like to thank the witnesses for their time and I look forward to a spirited discussion.







LISA MURKOWSKI
ALASKA

COMMITTEES:
ENERGY AND NATURAL RESOURCES
RANKING MEMBER

APPROPRIATIONS

HEALTH, EDUCATION, LABOR,
AND PENSIONS

INDIAN AFFAIRS

United States Senate

WASHINGTON, DC 20510-0203
(202) 224-6665
(202) 224-5301 FAX

510 L STREET, SUITE 600
ANCHORAGE, AK 99501-1956
(907) 271-3235

101 12TH AVENUE, ROOM 329
FAIRBANKS, AK 99701-6278
(907) 456-0233

800 GLACIER AVENUE, SUITE 101
JUNEAU, AK 99801
(907) 586-7277

805 FRONTAGE ROAD, SUITE 105
KENAI, AK 99611-9104
(907) 283-5808

1900 FIRST AVENUE, SUITE 225
KETCHIKAN, AK 99901-8050
(907) 225-6880

851 EAST WESTERN DRIVE, SUITE 307
WASILLA, AK 99654-7142
(907) 376-7605

March 4, 2014

The Honorable Blake Farenthold, Chairman
The Honorable Stephen Lynch, Ranking Member
Subcommittee on Federal Workforce, U.S. Postal Service, and the Census
House Committee on Oversight and Government Reform
2157 Rayburn House Office Building
Washington, DC 20515

Dear Congressman Farenthold and Congressman Lynch,

Thank you for providing this opportunity for Members of the Alaska delegation to share our perspectives about the importance, cost savings, Constitutional issues, and proposed legislation regarding the "bypass mail" system. I especially appreciate your willingness to include my statement in the record of the House Committee on Oversight and Government Reform.

As you are aware, Congress expects the United States Postal Service to deliver mail to every community in America. As it is so elegantly stated at 39 U.S.C. § 101(a), "The Postal Service shall have as its basic function the obligation to provide postal services to bind the Nation together through the personal, educational, literary, and business correspondence of the people. It shall provide prompt, reliable, and efficient services to patrons in all areas and shall render postal services to all communities."

In furtherance of this mandate to provide universal service to every American, the United States Postal Service transports mail in a variety of unconventional ways, including by donkey to a community at the bottom of the Grand Canyon, by boat to islands off the coast of Maine, and by air to the 82 percent of Alaskan communities that are not accessible by road. As the Postal Regulatory Commission has stated, for many rural Alaskan communities, "Surface transportation, by road, rail or water, simply does not exist."

What is "bypass mail"? It is a process, not a type of mail, whereby 1,000 pound pallets of Parcel Post packages that meet certain requirements for size, shape, weight, and content literally bypass Postal Service facilities. These pallets are prepared by a shipper, tendered directly to a qualified air carrier, and delivered to an addressee—often a village store, tribal government, school district, or health clinic. It is an ingenious system first created in the 1970s when Parcel Post mail volumes began to exceed the Postal Service's operational and facility capacity.

I share your desire to save the United States Postal Service's ability to bind together all corners of our nation, and to maintain our historic commitment to treat each American equally through universal service. The bypass mail process contributes to that effort. It also contributes, as

currently constructed under the Rural Services Improvement Act, to the Postal Service's financial viability.

The bypass mail system saves the Postal Service an estimated \$13.4 million per year in operating costs alone by allowing a huge volume of qualifying Parcel Post mail to literally bypass postal facilities. The Postal Service pays only for transporting this volume, which they would be required to do under any circumstances. This estimate does not include the cost of processing and post office facility expansion that would be required if the Postal Service had to re-absorb this volume—a cost the Postal Service calls “prohibitive”.

Bypass mail also helps to make federally-funded programs more efficient and cost effective—clearly a goal that many of us share on both sides of the aisle. For example, bypass mail, because it is cheaper than regular air freight, saves the USDA money when the Food Bank of Alaska ships The Emergency Food Assistance Program (TEFAP) food aid to rural communities in Alaska. Since it is more cost-effective to fly planes that are full each way, the bypass mail system also incentivizes bypass mail air carriers to carry passengers. This has resulted in 40 fewer communities that qualify for Essential Air Service, thus saving the federal government millions of dollars.

Several proposals have been introduced over the last several years with the intention of saving money in the bypass mail process. Most recently, H.R. 4011, the Alaska Bypass Fair Competition Act was moved out of this Committee. While H.R. 4011 was introduced under the free-market theory that greater competition among mainline carriers would lower costs for the Postal Service, the bill would actually result in higher costs for the Postal Service. Adding carriers to fly a finite amount of mail would only serve to discourage them from investing in larger, more efficient aircraft. The larger and more efficient the aircraft, the more money the Postal Service saves in transportation costs.

Last Congress, legislation was introduced that would have required the State of Alaska to reimburse the Postal Service for the cost of transporting mail via the bypass mail system. I asked the Congressional Research Service to review this proposal. Their conclusion was that while the U.S. District Court for Alaska and the 9th Circuit Court of Appeals have found the Rural Service Improvement Act to be constitutional under both the Equal Protection Clause and the Due Process Clause, the proposed change would violate the Tenth Amendment of the U.S. Constitution by: 1) “commandeering” the state to enact a statute appropriating state funds to pay this cost; and 2) charging the State a tax or user fee for a disproportionate share of the cost of bypass mail.

In Alaska, we routinely figure out ways to overcome our challenges. The bypass mail process is one such example. In fact, the Postmaster General has said, “The current bypass mail process is the most cost-effective and efficient way for the Postal Service to handle the large Parcel Post volume for Alaska.”

Another important aspect of the bypass mail process is that it helps to keep costs down for Americans who must daily deal with some of the highest prices for food, fuel, electricity, goods and services in America. Rural store owners are paying exorbitant prices for fuel to heat their stores and keep the lights on. They must pay higher than average salaries to their employees because of the high cost of living in our villages, where prices for everything are often twice that of Anchorage and four times greater than in the Lower 48. Just imagine paying over \$90 for a case of bottled water in a community that has no other safe source of water to drink. That is reality in many Alaskan communities, and why it simply costs more to live and do business in rural Alaska.

The bypass mail process costs the United States Treasury absolutely nothing, and saves the Postal Service money. The bypass mail process—as it is currently constructed—is the most cost-efficient method for delivering mail to rural Alaska until Congress returns the vast swaths of federal lands to the state’s control and assists us in building the kind of road networks that the Lower 48 enjoys. I strongly encourage this Committee to leave the Rural Service Improvement Act out of postal reform legislation. I appreciate your consideration of my comments. If you have any questions, I would be happy to assist you.

Sincerely,

A handwritten signature in black ink, appearing to read "Lisa Murkowski". The signature is fluid and cursive, with a large initial "L" and "M".

Lisa Murkowski
United States Senator

cc:
The Honorable Darrell E. Issa, Chairman
The Honorable Elijah Cummings, Ranking Member
House Committee on Oversight and Government Reform



OFFICE OF INSPECTOR GENERAL
UNITED STATES POSTAL SERVICE

December 14, 2011

The Honorable Lisa Murkowski
United States Senate
Washington, DC 20510

The Honorable Mark Begich
United States Senate
Washington, DC 20510

The Honorable Don Young
U.S. House of Representatives
Washington, DC 20515

Dear Senators Murkowski and Begich, and Mr. Young:

We received your December 2 letter responding to our paper on the Alaska Bypass program. You raised nine specific points of inquiry about our findings, which we will address below. But first I wanted to restate the main message of the white paper, which should serve to address some of your broader concerns with the paper's key findings.

Our office is aware of the unique challenges Alaska faces in the distribution of commercial goods throughout the state. We realize that if mail service to Alaska were provided in the same manner it is to other states, Alaskans could be left to pay for the transportation of many of the materials that now travel via the Alaska Bypass program. While Alaska does have special challenges due to its lack of an adequate road and highway infrastructure, we believe that the costs associated with these challenges should be borne by state or federal taxpayers rather than Postal Service customers. The report did not address the reasons why Alaska has not constructed such an infrastructure, but your letter identifies the challenges states face in doing so. The federal government has traditionally served in the role of assisting in coping with such issues, but it is problematic for the Postal Service, since its revenues should be used strictly to provide universal mail service. Postal revenues are collected from customers, not taxpayers, and the Postal Service has a duty to collect only such revenues as are needed to deliver mail, except as directed by law.

We continue to believe the current arrangement ought to be reviewed. Your questions are important ones, but the report's key points are also useful to frame in this discussion. Legislation that originated in the 1970s required the Postal Service to expend resources to provide services in the state of Alaska that are much greater than those provided to citizens in the rest of the country. The services include transportation of material, often commercial goods delivered to merchants for retail sale, which would be unrecognizable as a mail product elsewhere in the United States. Also, the Postal Service is required to pay non-competitive rates to select air carriers, rather than entering into contracts through fair and open competition with carriers, as all of its other air services are negotiated and provided in the U.S. and internationally.

Our paper makes no specific policy recommendations; instead, we discuss various options for consideration. You point out a number of relevant factors that could be included in any actual restructuring of the program, but they go beyond the general discussion presented in the white paper. Indeed, additional work will be required if the conversation shifts to the development of actionable policy on the matter. A key point of the paper is that while the Postal Service must remain fully committed to providing universal service to all Americans, Alaska Bypass is different. It is a program unique to the needs of a single state and appears to go beyond the Postal Service's universal service obligation to postal customers.

The following paragraphs address the specific concerns raised in your letter.

- Q1. *"The U.S. Postal Service (USPS) is, as you know, mandated to provide universal service at universal rates to all communities in the United States. Given that 82 percent of Alaskan communities lack road access, in large part because ownership of lands in Alaska is such that it is nearly impossible to build terrestrial roads, the USPS has met the universal service mandate by flying all classes of mail to delivery points located off the road system with the exception of a few communities where hovercraft are used. Please explain why your staff at the Risk Analysis Research Center chose not to include that fact in their analysis."*
- A1. We agree that mail in Alaska needs to be flown due to infrastructure challenges. As a result, our white paper excludes mail products in its discussion because our report specifically deals with Bypass shipments, which are goods ordered in minimum quantities of 1,000 pounds that are moved on shrink-wrapped pallets that bypass the post office network entirely. These shipments, as presently prepared and entered into the Bypass system, are not considered mail products anywhere else in the country.
- Q2. *"Among the recommendations your report makes is that the Postal Service charge Priority Mail rates for moving Parcel Post mail via the bypass mail system; the report reasons this is fair because bypass mail carriers often exceed the USPS bypass mail air delivery service standard of 2-7 days, which is comparable to the Lower 48 ground delivery standard of 2-8 days. Please respond as to whether the report's analysts determined whether or not the Lower 48 ground delivery standard is ever exceeded and if they calculated whether slowing bypass mail delivery would save the USPS any money."*
- A2. Our report makes no formal "recommendations." One suggestion we make, as part of a non-exhaustive list of possible policy options, would be for Bypass shipments to pay rates based on the service they get, which more closely resembles Priority Mail than Parcel Post.
- Q3. *"Further, the report did not recognize that the bypass mail system relieved the USPS of the need to pay for staff, equipment, and facilities to process the Parcel Post goods shipped to rural Alaska. We understand that the analysts who wrote the report assumed that capacity would have to be provided but conceded they*

did not calculate the cost of doing so. We strongly believe that recommendations should not be made on assumption, and urge you to fully calculate the costs of the staff, equipment, and facilities that would be necessary to process Parcel Post goods shipped to rural Alaska. Please provide us with that analysis as soon as it is available."

- A3. We agree, and our report notes, that Bypass relieves the Postal Service of some costs. We say "[t]he goods 'bypass' the Postal Service entirely, saving it handling costs and time." We agree that the paper does not include a detailed analysis of what the savings would be for the Postal Service if the Bypass program were to go away. We do not know how much of the Bypass volume that is presented on several hundred pound pallets would convert to 70 pound or lighter parcels meeting the requirements for all other parcel mail in the country. The typical items sent through Bypass more closely resemble freight and some do not appear mailable under current Postal Service regulations. Also, given that service would default to Parcel Post mail standards in Alaska, it is unclear how much volume might remain as mail or whether much of it would migrate to commercial freight. Further, if the air market were opened to fair competition, this would affect the costs as well. These factors and others certainly would be studied if the program were to come under further review once specific proposals are structured.
- Q4. *"Additionally, the report alleges that 'attempts to modify the bypass mail program have continued to be met with determined resistance from Alaska stakeholders'. We question what stakeholders your office met with, given that airlines participating in the bypass mail system have been working for well over a year to develop proposals for additional efficiencies in the program in concert with USPS and DOT."*
- A4. We have collected voluminous evidence, which was reinforced by our staff's interviews with stakeholders such as airline employees, bypass shippers, Alaska residents, and postal personnel, that leads us to conclude that resistance to modifying the Bypass program is strong. One recent article published in the magazine *First Alaskans* is typical: "Any changes to the [Bypass] program cause a stir." Such concerns have been well documented over the past 20 years and include not only airlines, but also town governments, town commercial interests, and others. Your letter and press release are further evidence that suggesting a revision to the program will be received with opposition.
- Q5. *"Another statement we question is that, 'The State of Alaska's permanent fund could theoretically be used to pay for the program or improve the state's ground and air infrastructure for the benefit of all Alaskans.' We question why Alaska should pay for services provided to the Lower 48 at no cost and again whether your office considered that much of the land over which the recommended infrastructure would be built is either protected from any type of development or in areas that prevent road construction and maintenance."*

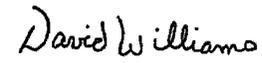
- A5. We are not suggesting that Alaska pay extra for mail services. Rather, we suggest the state pay for these unique shipments on the Bypass program that are not mail products, but are more like freight, and would move as freight services at freight rates in any of the Lower 48 states. You noted the challenges to states in building roads and infrastructure. This is not the subject of our report, but the consequences of those needs are typically addressed by the state and federal government, rather than Postal Service customers.
- Q6. *"Your report also alleges that rural residents are unjustifiably denied affordable grocery prices because rural store owners charge as much as 100 percent more for items such as potato chips than urban stores regardless of the 'significant transportation savings they enjoy' through the bypass mail system, which could be 'as little as about 35 cents' per item. Please provide the basis for this assumption given the other factors that drive grocery prices in rural Alaska, such as the cost of fuel, utilities, health care, housing, and wages – information that the report's analysts were able to access through the use of the Alaska Department of Labor's Alaska Economic Trends and the Alaska Geographic Differential Study. On a related point, please explain the basis for the statement, 'milk in Bethel costs less than retail milk in Anchorage,' since dairy prices in Bethel are historically and currently significantly higher in Bethel than in Anchorage - on November 28, 2011, the price of a gallon of Lucerne 2% milk at the Anchorage Carrs/Safeway costs \$3.39 while a gallon of that same milk cost \$6.99 in Bethel at the Alaska Commercial Company."*
- A6. We agree that prices vary at any given time and location and for a variety of reasons. However, your example of milk prices seems to support our conclusion that goods in rural areas are excessively higher than in the cities, despite the relatively small cost to transport the goods to the rural stores. The grocery store cost findings in our paper are meant to be demonstrative examples and not a comprehensive analysis. That is why we used the careful analysis of the market basket of goods completed by the University of Alaska, Fairbanks, and reported by the State of Alaska. Likewise, our analysis was not intended to be a detailed review of the economics of the retail industry in rural Alaska. We were just trying to note that, regardless of the reasons, rural customers are paying high prices and do not seem to be major beneficiaries of the Bypass program.
- Q7. *"We would also like to understand the statement, 'the cost-regulated DOT rate system ensures that airlines' costs are covered and there is little incentive to reduce those costs since the Postal Service must pay them.' Please explain how this statement is accurate, given that rates are based on a cost pool system that is updated frequently and that carriers with lower than average costs earn higher profits than those with higher than average costs."*
- A7. There is strong evidence that fair and open competition and efficient market forces can result in lower prices than cost-regulated systems in such settings. Congress' reform of the cost-regulated DOT rate for international air mail is a perfect example. The Postal Service now contracts directly with airlines for

international airlift. The Postal Service previously estimated its costs would be reduced by half with deregulation and its air transportation costs are indeed declining significantly following the passage of the Air Carriage of International Mail Act in 2008.

- Q8. *"Further, the report states that bypass mail has created a greater passenger air service supply than there is demand and cites the 90 flights per month between Anchorage and King Salmon compared to the 80 flights per month between Anchorage and Juneau. Please justify this comparison, given that the planes flying between Anchorage and Juneau are often 144-seat Boeing 737-400 jets and the planes used to fly between Anchorage and King Salmon are often Saab 340/340B turboprop commuter planes that have a maximum of 36 seats."*
- A8. Our paper is making the point that Alaska Bypass has created an over-capacity in the Alaska passenger market, and the Postal Service pays for some of those costs. A more precise way to look at this is by seats. Using the examples of plane capacity provided in the question, King Salmon, with only 374 residents, has 3,240 seats each month from Anchorage or more than 8 seats a month for every resident. Juneau, with a population of 31,275, has 11,520 seats from Anchorage each month, or about one seat for every three residents. In addition, only about 47 percent of the seats are filled to King Salmon while about 70 percent are filled to Juneau. This compares to capacity utilization of about 82 percent nationwide.
- Q9. *"Lastly, the report states, 'the Alaska state government does not bear the costs associated with providing necessary air or ground infrastructure' and claims that the State of Alaska 'gains infrastructure subsidy and landing fees' as a benefit of the bypass mail system while shouldering none of the cost impacts. Please comment on the source of these statements since we are told that the State of Alaska owns or maintains 254, or over 36 percent, of the 700 registered airports in Alaska, including many of those in bypass mail communities, currently spends \$33 million annually to maintain the state's Rural Airport System, spent \$14 million to improve the Emmonak airport due to its designation as a bypass mail hub by USPS, does not charge landing fees, and receives no infrastructure subsidy from the USPS."*
- A9. We agree some costs of the infrastructure are paid for by the state of Alaska and private interests. Our point is that those remaining costs should not be borne by Postal Service customers, but supported by state and federal tax revenues. We also note that the largest airports in Alaska collect landing fees, and all Bypass shipments originate through two state-owned airports with landing fees, Anchorage and Fairbanks.

Thank you for your interest in our paper. If you or your staff has any additional questions about our work, please contact Walter Olihovik, Director of Government Relations, at 703-248-2100.

Sincerely,

A handwritten signature in cursive script that reads "David Williams".

David C. Williams
Inspector General