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OVERVIEW OF MILITARY RESALE PROGRAMS

HEARING

BEFORE THE

MILITARY PERSONNEL SUBCOMMITTEE

OF THE

COMMITTEE ON ARMED SERVICES
HOUSE OF REPRESENTATIVES

ONE HUNDRED TENTH CONGRESS

FIRST SESSION

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OVERVIEW OF MILITARY RESALE PROGRAMS

HOUSE OF REPRESENTATIVES,
COMMITTEE ON ARMED SERVICES,
MILITARY PERSONNEL SUBCOMMITTEE,
Washington, DC, Tuesday, March 13, 2007.

The subcommittee met, pursuant to call, at 10:03 a.m. in room 2212, Rayburn House Office Building, Hon. Vic Snyder (chairman of the subcommittee) presiding.

OPENING STATEMENT OF HON. VIC SNYDER, A REPRESENTATIVE FROM ARKANSAS, CHAIRMAN, MILITARY PERSONNEL SUBCOMMITTEE

Dr. SNYDER. The hearing will come to order.

Today, the subcommittee turns attention to a topic that is of great value to the members of this committee, the military retail stores. These stores have been so important to our men and women in uniform and their families, and each year, we look forward to getting an update on the status of how we see these military retail facilities.

Without objection, all of your opening statements will be made part of the record, and I hope in this hearing today that you all take this opportunity to let us know of any problems or issues that you think we need to deal with in this year's Defense Bill or in any kind of a funding issue.

Before introducing the panel, I will yield to Mr. McHugh, who has also been a champion of this cause, for any comments he may want to make.

[The prepared statement of Dr. Snyder can be found in the Appendix on page 35.]

STATEMENT OF HON. JOHN M. MCHUGH, A REPRESENTATIVE FROM NEW YORK, RANKING MEMBER, MILITARY PERSONNEL SUBCOMMITTEE

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

I would ask unanimous consent——

Dr. SNYDER. Without objection.

Mr. MCHUGH [continuing]. That my opening statement be submitted in its entirety.

[The prepared statement of Mr. McHugh can be found in the Appendix on page 37.]

Mr. MCHUGH. Thank you, sir. Just a few comments.

First of all, welcome to our witnesses—friendly faces, familiar faces—all to this subcommittee, and gentlemen, let me say, we continue to appreciate your efforts on behalf of the important interest that you represent.

I think, Mr. Chairman, if you will look at the testimony that has been submitted here today, we are reminded once more of how amazingly successful these good folks have been in satisfying customer expectations and providing substantial savings to their patrons, accommodating organizational and financial challenges. They have found efficiencies to do more with less. As Pat Nixon notes in his testimony, when you measure in constant dollars what the Commissary benefit and its Administration costs today, it really remains below what it cost in the year 2000, and all of that has happened not at the expense of the customers, but because of those efficiencies and the expertise and the hard work of the folks who are scattered throughout the agency.

I would just say, Mr. Chairman, I would hope our witnesses today will help us understand the significant challenges that they are facing right now. They are beginning to form, those who are looking out on the horizon toward—there are many. There is base realignment and closure (BRAC). There is global rebasing, pressure on appropriative funds, support, the skyrocketing costs of construction, the commercial competition that is ever present, declining Morale, Welfare, and Recreation (MWR) dividends. It sounds depressing, but there are those and others, and we want to make sure that they are not left unaddressed, and we welcome their comments as to how they plan to go forward and, of course, most importantly, Mr. Chairman, how we can be supportive in that effort.

So, with that, Mr. Chairman, I thank you for convening this hearing, and I look forward to our discussions.

Dr. SNYDER. Thank you, Mr. McHugh.

Our panel today is the Honorable Michael Dominguez, the Principal Deputy Under Secretary of Defense for Personnel and Readiness; Major General Paul Essex, Commander, Army and Air Force Exchange Service; Rear Admiral Robert Cowley, III, Commander of the Navy Exchange Service Command; Mr. Patrick Nixon, the Director and Chief Executive Officer (CEO) of the Defense Commissary Agency; Mr. Michael Downs, Director of Personal and Family Readiness Division Headquarters, United States Marine Corps.

Gentlemen, we appreciate your being with us. As I said before, your written statements are going to be made a part of the record. You all are well-known to us, and we appreciate your patriotism and support of our men and women in uniform.

Mr. Secretary, we will begin with you and then go right down the line.

STATEMENT OF HON. MICHAEL L. DOMINGUEZ, PRINCIPAL DEPUTY UNDER SECRETARY OF DEFENSE (PERSONNEL AND READINESS)

Secretary DOMINGUEZ. Thank you, Mr. Chairman, Representative McHugh and distinguished members of the subcommittee. I am honored to appear before you today to discuss the Military Commissary and Exchange Program.

The President's budget submission for fiscal year 2008 continues the Department's strong support for service members and their families. Commissaries and exchanges are an essential component of our quality-of-life programs, and I would like to thank the sub-

committee for its support in helping the Department sustain the commissary and exchange benefits for our soldiers, sailors, airmen, and Marines.

The road ahead is a challenging one for our military families and the resale institutions that serve them. Our commissaries and exchanges are supporting military personnel and their families as the force mobilizes, deploys and rotates in large numbers. Access to the benefit is a pressing concern as we bring thousands of military families home from overseas and close and realign bases. Finally, our resale activities must respond to rising customer expectations and the reality of competition in the global and networked marketplace.

Our success in meeting these challenges requires that we set and achieve ambitious goals in cost reduction, improved customer value and improved access to these benefits. We must continue to enable and encourage creativity, experimentation and imagination in adapting to the challenges we face. We do not believe, however, the challenges we face warrant consolidation or merger of our various resale activities.

With respect to the exchanges, we reported last year that, instead of proceeding with the recommendations of the Unified Exchange Task Force, the individual exchange boards assumed responsibility for deciding the way ahead. I am pleased to report that the exchange boards completed their review of the future of the retail industry and their exchange strategic plans. The exchange boards have set a course of action for the exchange commanders to develop cooperative efforts to maximize efficiencies in systems, logistics and supply. To maintain momentum, I will ensure we create strong performance goals and effective oversight mechanisms. With the individual and collaborative efforts underway, I have every confidence that our exchange programs will successfully transform to the new defense environment, and I want to echo Congressman McHugh's accolades to these gentlemen for leading that way and to Pat Nixon for the extraordinary stewardship of the Commissary Agency.

In conclusion, the Department of Defense (DOD) is committed to seeing our commissaries and exchanges meet the challenges of changing expectations, a changing marketplace and a global repositioning of U.S. Forces. We thank you for continued congressional support, and I look forward to answering your questions.

[The prepared statement of Secretary Dominguez can be found in the Appendix on page 40.]

Dr. SNYDER. Thank you, Mr. Secretary.

Let us go to General Essex.

STATEMENT OF MAJ. GEN. PAUL W. ESSEX, COMMANDER, ARMY AND AIR FORCE EXCHANGE SERVICE, U.S. AIR FORCE

General ESSEX. Thank you, sir.

Mr. Chairman and members of the subcommittee, as Commander of the Army and Air Force Exchange Service (AAFES), it is my privilege to once again appear before this subcommittee. On behalf of the military community we serve, I thank this subcommittee for its continued support of the exchange benefits and quality-of-life programs.

AAFES has a long and proud history of service and support to America's armed forces, and 2006 was no exception. We continue to fulfill our mission to provide quality merchandise and services at competitively low prices and to generate earnings for the Army and Air Force morale, welfare and recreation programs. This foundation of service and support is at the center of all we do at AAFES.

No matter where military members serve, AAFES provides a comprehensive and customer-focused benefit either online, by catalog, or in the more than 3,100 facilities around the globe. Many, if not all, members of this subcommittee have visited our deployed troops and witnessed the AAFES team in action. AAFES operates more than 50 field exchanges, well over 100 name-brand fast-food operations, 69 phone centers and hundreds of concession activities throughout Iraq, Afghanistan, Kuwait and the Horn of Africa. This is one of the most important jobs AAFES will ever do.

All of this would be impossible without the dedicated and enthusiastic AAFES workforce. About 450 devoted AAFES volunteers are deployed in support of Operations Enduring Freedom and Iraqi Freedom, and I would add that we have more volunteers than we have requirements to send them, so it has been a particularly heartwarming experience for me to lead these folks.

In 2006, AAFES embarked upon one of its most challenging years in recent history. Remarkably, we project AAFES revenues for 2006 will reach $8.9 billion and an increase of $257 million over 2005, and we expect to provide contributions to MWR in excess of $221 million. AAFES receives minimal indirect appropriated funds to support exchange operations. The largest component, $136 million, was applied to Second Destination Transportation (SDT) expenses, which enables AAFES to provide balanced pricing for soldiers and airmen stationed overseas. This funding also fulfills congressional intent to provide the staples of an American lifestyle and improve the quality of life for military families serving abroad.

I want to personally thank this subcommittee for its leadership and for the support of the AAFES SDT funding. We take our role as stewards of these appropriated funds very seriously. AAFES implemented a number of initiatives that avoided $18.6 million in SDT costs last year. We must not forget that there are significant challenges, which inhibit our ability to remain responsive to the needs of those we serve. AAFES will continue to advocate for the repeal of merchandise restrictions that deny the Army and Air Force families the ability to buy a more extensive range of products and services. If they cannot purchase what they want, when they want it from their exchange, they will look elsewhere.

Another challenge for AAFES is the impact of the Base Realignment Closure, BRAC, and global posture and realignment. In gaining locations, military construction appropriated funds are authorized. Unfortunately, AAFES will be required to expend the service members' dollars in lieu of appropriated funds (APF) because the services have not programmed funds for these projects. We recognize the intense budget pressures of a wartime environment. However, it is a fact that every nonappropriated dollar spent on authorized APF functions negatively impacts quality-of-life programs.

For many years, the military exchange services—may I finish?—have participated in cooperative efforts, collaborating on projects of common value. In 2006, the Exchange Cooperative Efforts Board chartered four cross-functional teams to focus on efficiencies in logistics, procurement, gift cards and information technology. We have made great progress in strengthening these relationships and in defining our common objectives.

Discussions on mutually beneficial cooperation are not limited to the exchanges. AAFES recently began exploring initiatives with Defense Commissary Agency (DeCA) that focus on win-win opportunities for both organizations. These combined efforts should result in benefits for AAFES, DeCA and, most importantly, for the military community.

In summary, while AAFES continues to meet the unique and diverse needs of service members and their families, the road ahead is a difficult and challenging one. The actions we take together today will ensure the long-term fiscal viability of AAFES tomorrow with the focused and dedicated effort on our mission of serving the best customers in the world.

Thank you, and I look forward to your questions.

[The prepared statement of General Essex can be found in the Appendix on page 54.]

Dr. SNYDER. Mr. McHugh and I would like to be able to claim credit that we run the clocks around here, but we do not. That was actually the 15-minutes notice that the House will be going into session at 10:30, and we are not anticipating, I do not think, any interruptions in this hearing today from votes. Although, having said that, I will probably be surprised. In another 15 minutes, we will hear the votes go off, announcing we are going into session.

Admiral Cowley.

STATEMENT OF REAR ADM. ROBERT E. COWLEY, III, COMMANDER, NAVY EXCHANGE SERVICE COMMAND, U.S. NAVY

Admiral COWLEY. Good morning, Mr. Chairman, Representative McHugh and distinguished members of the subcommittee. It is my privilege to represent Navy Exchange and our dedicated associates worldwide. Navy Exchange and the Navy family thank you for your steadfast support of the Navy Exchange benefit. I provided my written statement for the record, and I will take this opportunity to briefly report on Navy Exchange.

Research shows quality-of-life programs positively and directly affect recruitment, retention and the performance of service members. The Navy's Spouse Survey, recently published in February 2007, revalidated this. When asked to identify the top 10 most important support programs, both enlisted and officer spouses ranked the Navy Exchange within the top five. Our Navy families clearly recognize the importance of the exchange benefit.

Navy Exchange is integral to the Navy's quality-of-life mission. We directly support the Chief of Naval Operations Navy Professional Reading Program. We support and participate in the Navy's wellness and healthy lifestyle programs. We support Task Force Financial Health in helping junior enlisted members better manage credit. We provide spousal employment with 24 percent of our associates' military spouses. Further, we provide for continuity of em-

ployment for spouses as members transfer, and we assist in the Navy's Disaster Relief mission, and these are just a few of the areas where we participate. All of these initiatives leverage our mission of service to our members.

Navy Exchange operates under a balanced scorecard using commercial performance metrics. We use a commercial firm to validate customer savings that average 26 percent, including sales tax. Our Customer Satisfaction Index, also reported by a commercial firm, continues an 8-year improving trend with a score of 79 for 2006. This score places us in the top quartile of commercial retailers that participate. This year's survey shows savings as the single most important factor to our customers. The commercial retailers measure our financial performance through sales and profit execution to plan. Our total sales have been on a continuing upward trend since fiscal year 2001, meeting or exceeding our board of directors' approved targets. Likewise, our profit execution has consistently met the board's identified requirements for MWR dividends and recapitalization, and we are continuing to improve the viability of future exchange benefits.

I am pleased to report that our integrated commercial Enterprise Information System, Oracle Retail, is deployed and operational. Together with the other exchanges, Navy MWR and the Defense Commissary Agency, we are seeking and discovering efficiencies across combined operations to further improve the quality of life for military members. Our passion is caring for sailors and their families, and we do this through over 1,300 stores and outlets. We do this afloat for our Ships Store Program on 192 Navy and military sea-land command ships. We keep sailors in touch with family through our telecommunications programs. Our Navy Lodge Program supports sailors and families with clean, affordable accommodations. The Navy Lodge Program continues to support wounded service members returning from Operations Iraqi Freedom and Enduring Freedom. Navy Lodge has provided over 13,000 room nights in 2006 to families of injured service members as well as to the service members themselves.

Bottom line, we are a touch of home when our sailors are overseas or afloat. We are a safety net for their families when they are deployed.

In closing, I would like to say how proud I am of our Navy Exchange teams who take care of our sailors and their families who serve worldwide every day with great dedication. Together with help from our many industry and government partners as well as the strong support from this subcommittee, we are able to do more for our deserving military families.

On our sailors' behalf, I thank you, and I stand ready to take your questions.

[The prepared statement of Admiral Cowley can be found in the Appendix on page 64.]

Dr. SNYDER. Thank you, Admiral.

Mr. Nixon.

STATEMENT OF PATRICK B. NIXON, DIRECTOR, DEFENSE COMMISSARY AGENCY

Mr. NIXON. Thank you, Congressman Snyder.

Congressman McHugh, Congresswoman Drake, thank you.

It is my pleasure today to provide an update on the performance of the Defense Commissary Agency this past year.

In 2006, we have seen the commissary benefit grow in importance in the eyes of our customers as we serve the families of service members deployed around the world, many in harm's way. The commissary is truly the rallying point for military families and provides those deployed with a sense of security that their loved ones are being taken care of while they are away from home. The 18,000 employees who operate the commissary system continue to be a source of personal pride as they rise again and again to deliver astonishing business results in the face of significant resource challenges. Once again, DeCA reached new highs in sales performance and customer service. Our customers continue to express their satisfaction with our service, giving us the highest scores ever on the Commissary Customer Satisfaction Survey. In addition, the external independent evaluation provided by the American Customer Satisfaction Index ranked DeCA second in customer satisfaction among the largest private-sector supermarket chains in the United States. At the same time, we have maintained the level of savings our customers enjoy at 32 percent, providing the average family of four almost $3,000 a year in additional disposable income.

Finally, the cost of providing the commissary benefit when measured in constant fiscal year 2000 dollars continues to decrease, vividly demonstrating that we have increased the value of the benefit without increasing the cost.

On the governance front, DeCA continues to demonstrate the attributes of a model governmental entity. DeCA received its fifth clean audit opinion on its financial records from its commercial audit firm. Further, not only was DeCA's Fiscal Year 2006 Annual Statement of Assurance Scorecard rated the highest in DOD, but the Department's comptroller consistently holds DeCA up as a model for other DOD activities to emulate in implementing their internal control programs. We continue to focus on reengineering our organization and operations to remain recognized, responsive and relevant to the military of today and of the future. Our key initiatives remain on track as well.

The DeCA/TRICARE partnership for the "It's Your Choice, Make it Healthy" program, highlighting healthy foods available in military commissaries, has been extremely successful in informing military families about eating healthier and promoting concepts such as weight management and fitness. With the addition of a dietitian to the DeCA staff, we have increased our ability to educate customers on how to make healthier meal choices at the commissary.

Our change in produce procurement also remains on track. While we are working through some award challenges and minor start-up problems, we continue to push forward with this initiative. Adopting the best supermarket industry practices resulted in shoppers buying more produce. With higher quality and lower prices, we have seen patrons return to the commissary more often to do their fill-in shopping as a direct result of this program, raising their level of financial fitness as well.

At the same time, DeCA is expanding its organic food offerings as another healthy eating alternative. Of course, food safety is also

on everyone's mind. Thus, to provide an additional level of food security, which I believe commissary patrons deserve, I recently directed that the food products we buy for resale come from suppliers that observe the good safety guidelines established under the DOD-Approved Source Program.

DeCA's biggest challenge today is the strain placed on the surcharge account. The surcharge account was established during a time with predictable force structure, construction costs and investment models. BRAC and restationing actions are projected to impact 16 installations where DeCA operates commissaries and further compounds the strain on the surcharge account. There will be significant personnel increases at those locations, and our existing facilities will not be able to accommodate the increased patron demand. The requirements to build new or to renovate existing stores to serve those locations not only further taxes the surcharge account, but also will require deferring those projects that would have been next in line for replacement or for renovation under our planned construction program. In essence, it has negated the existing methodology of ranking and setting priorities for the investment of surcharge dollars. At this point, it appears the only solution is that we begin placing more emphasis on the repair and the renovation of existing stores in the future rather than building new.

We at DeCA are proud of the contribution we make in operating the 263 commissaries worldwide that provide tremendous savings on groceries for military personnel, retirees and their families. We recognize that commissaries deliver a highly valued component of military compensation, and they bring a morale-building taste of home by providing familiar American food products in overseas locations. Simply stated, commissaries contribute to family readiness, but we do not do it alone. It is a team effort.

Mr. Chairman, thank you for your support, and my thanks to all of you on this subcommittee for the continued emphasis that you place on the value of the commissary benefit. We also recognize our industry partners in their support of the commissary system, both through their excellent prices that they offer on commissary products and the direct contribution they make in supporting a number of activities designed to improve quality of life.

Once again, it has been my pleasure to have the opportunity to tell you about the great things at DeCA and the great accomplishments we have achieved over the last year. When all is said and done, it comes down to people taking care of people, and no one does that better than those at DeCA.

I look forward to answering your questions, sir.

[The prepared statement of Mr. Nixon can be found in the Appendix on page 80.]

Dr. SNYDER. Thank you, Mr. Nixon.

Mr. Downs.

STATEMENT OF MICHAEL P. DOWNS, DIRECTOR, PERSONAL AND FAMILY READINESS DIVISION, MANPOWER AND RESERVE AFFAIRS DEPARTMENT HEADQUARTERS, U.S. MARINE CORPS

Mr. DOWNS. Thank you, Mr. Chairman, Representative McHugh, Congresswoman Drake, for this opportunity to report on Marine Corps Exchanges.

Over the past year, your Marines deployed to all corners of the globe in support of our nation's combat requirements or humanitarian missions. The commandant of the Marine Corps has made it clear that those who sacrifice so much for our nation's defense should not be asked to sacrifice their quality of life. Exchanges and the MWR programs they support are a very important part of the nonpaid compensation benefit, and we appreciate your continued efforts to protect this benefit.

Our Marine Corps Exchange has evolved and continues to transform to new levels of operational excellence. In 2006, we achieved unprecedented sales and profits, resulting in a generous MWR dividend and support for a strong recapitalization program. While much of our efforts to date have been on back-of-the-house efficiencies, Marines and their families will soon see visible improvements as the renovation and the replacement of Marine Corps exchanges takes center stage in our Marine Corps Community Services non-appropriated funds (NAF) Construction Program.

Finally, I am pleased to comment on the productivity of the Exchange Cooperative Efforts Board. Through a spirit of increased trust and openness among our sister exchanges, our service departments and OSD, we will continue to work together to further initiatives designed to increase efficiencies and effectiveness.

Thank you for this opportunity to be here today and to represent the Marines and their families.

[The prepared statement of Mr. Downs can be found in the Appendix on page 96.]

Dr. SNYDER. Thank you, gentlemen, for your testimony.

I guess our pattern here over the last few months has been to put us on the clock, but when you see these lights go off, those are for the benefit of the members here. We want all of you to have an opportunity to answer these questions as you deem appropriate.

Mr. Dominguez, I guess the clock is running, but the light is not on, but I can see the time. Mr. Dominguez, let me just give you a softball question if I might.

You are a zealous advocate on behalf of our men and women in uniform. Is there anything in these topics that are being talked about this morning that keeps you awake a little bit at night or things that you think that Congress needs to be focused on as we head into this year's Defense Bill?

Secretary DOMINGUEZ. Sir, I think our progress on BRAC and restationing, you know, is a big deal. It is certainly the greatest turbulence in front of us in these areas. Associated with BRAC and rebasing, obviously, there are some tough things, I mean in particular around the closures. You know, those are really tough on communities, but they are necessary actions to take, and we will need to close bases. When the bases close, we need to close commissaries and exchanges.

For both you and I, for the committee and myself, I think it is continuing to advocate in that context for the appropriated funding to make sure that—for the new construction associated with BRAC or rebasing so that the Nation, you know, is able to prioritize these things and decide, you know, when the money runs out, that everything above the line is really, really important, and unfortunately, we did not—we were not successful in terms of the 2008 budget in doing that, but the advocacy and making the issue and making sure people understood the choices I think was important and continues to be, and that certainly is a dialogue that Congress now should take up.

Dr. SNYDER. You are referring to the $3.1 billion in the BRAC account? Is that specifically what you are referring to?

Secretary DOMINGUEZ. Yes. The $3.1 billion in the BRAC account, which—or another appropriated fund account in Military Construction in which we are authorized to build these new facilities through that, but we were unsuccessful. There just was not enough room in the budget, and there are higher priority things from the Administration's viewpoint.

Dr. SNYDER. And anybody can respond here.

Again, taking off on the issue of construction, what is the status of the rebuilding of facilities that were damaged or wiped out by the hurricanes in the south? I know we had an issue of Keesler. Can somebody give me an update there and on any other facilities?

General ESSEX. Yes, sir. I can speak to Keesler.

That goes off every time I talk; doesn't it?

Dr. SNYDER. I am taking back what I said. You know, I think it is related to you.

General ESSEX. I think it is. It is something about the tone or tenor of my voice.

At Keesler, we very much appreciate the support that we got from the subcommittee and from Congress in the funding to rebuild the soldiers and airmen's exchange at Keesler Air Force Base. We do have sufficient funding now, and we have got the interim, the temporary, exchange up and operating. And the replacement exchange is on the books and underway.

Dr. SNYDER. But "on the books" is different than "underway," isn't it?

General ESSEX. No.

Dr. SNYDER. Is it under construction?

General ESSEX. You know, I do not know if it is actually under construction yet. Yes, they are going to be breaking ground in April.

Dr. SNYDER. An April groundbreaking for the one at Keesler. I have about a half a minute left.

Any other facilities?

Mr. NIXON. Yes, sir.

Just as an update on commissaries, the Keesler commissary was destroyed. Gulfport was significantly damaged. New Orleans was not so much damaged, but you could not get to it. We have three facilities back open and running. New Orleans is back open and running, and it is running at about 79 percent of its previous capacity. Gulfport, a real success story, is running at pre-Katrina 159 percent. Keesler is running at about 37 percent. We have got a

great temporary facility there, some real ingenious folks who went into an old club and put a commissary in. They just added phase three of a deli operation there. Along with General Essex, the new store will break ground in April, probably, for the new facilities, and very thankfully, you provided the money for the replacement of the Keesler facility.

Dr. SNYDER. Mr. McHugh, I guess our clock is not working. I mean, the clock is working; the light is not working, a broken wire. General Essex probably did it.

General ESSEX. Yes, sir, I think I did.

Mr. MCHUGH. Thank you, Mr. Chairman.

Mr. Secretary, in your written statement, you made the comment that your departmental goal is to sustain the commissary and exchange benefits without increasing appropriated fund support. I think you heard me in my opening comments allude to the fact that the cost today, as Mr. Nixon noted, of operating DeCA, at least, is in 2007 dollars virtually the same as it was in 2000. I think we can all agree the exchange and commissary systems have done a terrific job in finding efficiencies in savings.

I have to begin to wonder now. While I understand that is an objective, what, if anything, would make you revisit that decision? I mentioned costs escalating, exploding costs of construction. I just would like to know if that is an open page. Is that a stated objective, or are we absolutely under no circumstances, regardless of what the tide may bring us, going to see a proposed increase in appropriated fund support?

Secretary DOMINGUEZ. Sir, that is our objective. It is not an impermeable barrier. If reality changes, we will have to change with it. You know, clearly, some things can happen like the, you know, exploding construction costs, those kinds of things, pension, health care costs. So those things are putting stresses. To date, these gentlemen and the boards that back them have been forward-leaning, creative, aggressive, I think, achieving the kind of performance improvement that we have seen in the private sector, who are both benchmarks and, to some degree, competitors.

Mr. MCHUGH. No good deed goes unpunished, right?

Secretary DOMINGUEZ. Yes, sir, but this is life in retail, and you know, as we evaluate those, as the boards look at the challenges in front of them, we will have to consider that, but as a goal going in, as I said, there is plenty of demand for the appropriated funds. There are plenty of high priorities that demand those resources, and if these gentlemen can keep hitting that goal, then that is great. If they cannot, the benefit is important. The quality of service is important. What people—our members and families—you know, the value they place in this is clear to us, as you heard here in the opening statements about the survey responses. So retention and recruiting are big deals. This is an important piece of this. This is a piece of the compensation package that we offer our service members, and we need to be true and honor that promise.

Mr. MCHUGH. I appreciate that. I would go so far—of course, I do not have to live by a particular manual, but I would go so far as quality-of-life issues, and this environment is a readiness issue. I strongly believe that.

Let me pose a conundrum to you. I know that you have got a review underway with respect to the adequacy of nonappropriated funds for DeCA, but if construction costs force you to the point, what would be the decision, to make a proposal to increase the five-percent cap on commissary prices or would DOD consider using appropriated funds? Where would you go first?

Secretary DOMINGUEZ. Um——

Mr. MCHUGH. I will get to the hard questions in a minute.

Secretary DOMINGUEZ. Yes, sir.

I am not sure where we would go first. I mean, I think we would have to consult the Commissary Operating Board and then, you know, go through the process inside of the Department. I am not an enthusiast for increasing the surcharge, you know, simply because that has been so much a part of our understanding of the commissary benefit for so long.

Mr. MCHUGH. Well, I am glad to hear you say that. I just have a few seconds, and I assume we will have other rounds. Just for the record, I am a damned opponent of raising the five-percent, but I want to underscore the fact that, in the commissary era, this is a retail challenge, and I think Pat would certainly agree. They have got to compete against the private sector, and the private sector is continuously modernizing stores, opening new stores and such, and if we cannot compete on that level, it is going to have a terribly, in my judgment, erosive effect on the customer base which, of course, starts downhill real fast. So I just want to suggest that, when it comes to appropriated funds, there are not a lot of other happy choices.

So I thank you for your comments.

Mr. Chairman, I yield back.

Dr. SNYDER. Thank you.

Mrs. Drake.

Mrs. DRAKE. Thank you, Mr. Chairman.

First, I would like to thank you all for being here and for what you do for our military families, and my only regret is I cannot shop in them, because they are truly beautiful, the ones I have visited.

Mr. Downs, I cannot sit here, looking at you, without telling you about the bumper sticker I saw Friday on my way home. It said, "Northern Virginia," and it said, "Sit down. Shut up. And let my Marine do his job." so I just have not been able to get that out of my mind, looking at you, but a couple of questions.

First of all, two weeks ago, Douglas McAlister with American Logistics Association (ALA) was here, and he talked about limited base access for non-DOD employees, and certainly, we understand the security issues, and we understand the costs for resale, but isn't there some way to move more quickly to get some sort—Mr. Secretary, I guess this would be to you—of a standardized clearance card to get access to the base and without making people duplicate their efforts to get that kind of a card?

Secretary DOMINGUEZ. Yes, ma'am.

You know, I have talked to the ALA leadership about this. I went down to a convention they were having and spoke to them, and got feedback from them. I understand this is an important issue for our partners, and so it is an important issue for me. We believe we

have the solutions that are compliant with Homeland Security Presidential Directive 12, and in fact, we are deploying that, you know, technology solution where you register people's credentials into a database that is then shared and accessible, and the deployment of that database, though, is complete in Europe. It is complete in Korea. We are now focused on deploying it in Southwest Asia, which obviously needs to be our first priority. Subsequent to that, we will be deploying in the United States as well, and that will help a great deal, and I believe that work is going on in partnership with ALA and organizations like that where their industry is also establishing its own credentials to standards identified by the U.S. Government and verifiable and transparent to us so that we can incorporate their credentialing into our systems and then make that data available to base commanders who ultimately determine who gets access to their bases. But there is a plan. There is a technological solution—I believe we are all agreed on that path—and it is just a question of getting it deployed.

Mrs. DRAKE. Do we have a time frame?

Secretary DOMINGUEZ. I do not right now.

Mrs. DRAKE. Okay. The next question would also be to you, and that one deals with, this committee often deals with: How do we encourage people to join the military? How do we retain people? One of the things I have been hearing a little bit about is—because we also want to recruit people who do not make it a career even though we want to recruit people who do want a 30-year military career, and one of the things I have heard out there is—and I know we do this with some health care for military members who have served in a combat zone.

Would there be a value to looking at commissary or exchange periods after discharge from the military for someone who is not retired? Is that one of the things we should throw out there as we look at, how do we attract the people who we need to fight the global war on terror?

Secretary DOMINGUEZ. Ma'am, if we are thinking about it as a recruiting tool for people who just want to do, you know, a tour for a six-year enlistment and then out, there are much more effective ways to deal with that than through a commissary benefit, you know, after you end your enlistment, so I would not see that as a big driver, a big attractor, to recruiting. There are much more effective ways.

Mrs. DRAKE. Does anyone else want to comment on that before I run out of time?

Mr. DOWNS. I would tend to agree with Mr. Dominguez.

Our folks who leave the services go to the wide expansive America, and commissaries and exchanges are in very limited places, so many of these departing service members are not going to find themselves in and around bases.

Mrs. DRAKE. Thank you.

Mr. Chairman, I yield back.

Dr. SNYDER. Sure.

Mr. Nixon, I cannot let the hearing go by, of course, without asking about produce.

Can you give us an update on the situation?

Mr. NIXON. Yes, sir.

Dr. SNYDER. I am going to hold off on any tattoo questions for this panel and just ask about—what is the update on the situation with regard to produce, and one specific question is, would you describe for us, please—what is the status—I think it was either in your written statement about the status of legal challenges to the new way of doing produce. I did not understand that.

Mr. NIXON. Yes, sir, and thank you for the personal interest that you have taken in produce and in our new procurement method.

We set out a goal of soliciting a new produce business model for 184 stores by October first. We accomplished that. And because these are procurements and some of the largest produce procurements that have been awarded in the retail industry, public or private sector, there was a great deal of interest.

To date, we have one active challenge, Government Accountability Office (GAO) challenge, outstanding for 31 stores in the northeastern part of the United States. In total, we have two agency-level challenges, seven GAO challenges, and I think three—because these were set aside, three Small Business Administration (SBA) challenges whether companies are small businesses or not. We have worked through all of the protests with the exception of the 31 stores in the northeast and a lawsuit in the southeast portion of the United States. None of these, except for the one in the Northeast, have impacted us proceeding with performance to awarding the contracts.

What we found is that, you know, the primary test area was in the Tidewater Area. We established that this business model was extremely effective. For two years in a row, they have had double-digit increases in sales, and we have benchmarked them against a very well-run chain there, Farm Fresh, and we have quadrupled our produce sales increases versus what they do.

But as with any venture where we have new contractors moving into new areas, there are some start-up issues with getting the right people in place, getting the right distribution points in place, getting the right sources in place. One of the issues that we have been watching closely is the Birmingham market. In fact, the Military Produce Group (MPG), who is the successful test company in the Tidewater Area, was awarded the southeastern portion of the United States, and they have had a few start-up issues. We have had some start-up issues. This is a new partnership, a new business relationship that we have undertaken.

I absolutely believe that applying commercial supermarket best practices is the way to go. I was even down in your area and happened to visit the Little Rock store. A fine, young, new produce manager down there came up from Key West. It is a significant increase in responsibility for her. So we provide additional training. Mr. Jerry McDonnell, the president of the Military Produce Group, I asked him to fly down and meet me there, and I said, let us look at the quality of the produce you have here as compared to the quality you have up in Oceana. And he did that, and there are a few things we have to work on, but I am absolutely committed that this is the right way to go, Mr. Chairman, and it will be successful.

Where we have issues or where we think the contractors are providing nonconforming products not up to standards, we do the normal things you do in a contract. We issue discrepancy reports. We

have our contracting officer first approach the contractor and give them, if necessary, a get-well notice, a cure notice, so we follow all the rules. I am very pleased with the direction produce is going, and it will be a signature department in the Defense Commissary Agency, and I welcome your visits often to the Little Rock commissary.

Dr. SNYDER. You may remember, Mr. McHugh, a couple of years ago, I did a little walk-through in the produce at the Little Rock Air Force Base, and it was really pretty abysmal—an abundance of molds and everything else—but we are dramatically—and I went back there just a couple of weeks ago, three weeks ago.

The issue of produce—and I assume that—I mean, I am not a retailer, but I assume that produce is kind of like eye candy for consumers. I mean, you walk in the store, and that is what you see, and that is what you want folks to see, and if you see in the first rack that it is not where it ought to be and it does not compare favorably with the folks downtown, it sends a bad signal for the whole store.

Mr. NIXON. Absolutely.

Dr. SNYDER. What is your monitoring system on this? I think the system is very responsive to my walk-throughs and questions and all, but are there stores sitting out there somewhere that do not have a member of Congress or a staff person close by? Or how do you all from your level——

Mr. NIXON. That is not the criteria.

Dr. SNYDER. How do you handle that in—no, I do not mean that.

Mr. NIXON. I understand.

Dr. SNYDER. I assume you will respond to complaints wherever they come from. I happened to be the one who walked through that one, but there may be people out there who, when they complain, the way they deal with it is they take their business elsewhere and do not let you know. I found you all very forthcoming on this.

So what is your system for monitoring in some kind of meaningful way so you can do checks on all of the stores?

Mr. NIXON. Sir, because of the importance of our perishable departments, we obviously have area managers who are focused just on the perishable departments. There is also a zone manager who does the overall operation, but in our Customer Satisfaction Survey, it measures 14 operational areas, all observable to the patron, I mean produce quality being one of those that allows us to benchmark stores against stores. So we will look at a store in an area that has a high score versus one that has a low score and use best practices and send that management team over to the store that needs some help improving. We monitor through a variety of sources, one including veterinary food inspectors, the quality of produce arriving at the back door. We reject it if it does not meet standards. It is rejected at the back door, and it should never make it into the produce department.

It is a leadership issue with me because, in fact, now the trend in the supermarket industry—it used to be the meat department. Meat was the draw. That is what you based your menu around was the meat department. It is not anymore. The produce department is what you build your menu around, and you are absolutely correct. The message that the patron gets when they walk in and look

at the produce is an evaluation of that store. Is everything in that store fresh? Is the store clean? Is there attention to detail? So, from a management perspective, I do inspections. I go out, and I want everybody to know that—you know, they always say that everybody pays attention to what the boss pays attention to. Produce is on the top of my list for the message we need to send, and I want—and I want patrons to realize that there is no place that they can go where they are going to get a fresher, better deal than at the Defense Commissary Agency. So I hope you sense my passion about this, and we introduced this procurement methodology to drive that kind of mentality, that kind of business approach for produce, not only the quality of produce but how the department looks when you come in, that it is a farmers' market. It is an open environment. There is excitement there. You do not know what is going to be on sale. That is what drives the excitement about——

Dr. SNYDER. Thank you, Mr. Nixon.

Mr. McHugh, you may recall that, I think a couple years ago, there was a hearing on the Little Rock Air Force Base. It was a hearing that you chaired in which we had a group of enlisted people here. I think it was the Marine Corps. I think it was a gunnery sergeant who—you know, we asked, what is going on? He just made mention that, you know, my wife keeps complaining about the produce at some base. Mrs. Drake was part of this whole thing, too, and that is what led to a lot of these discussions from me.

Mr. McHugh.

Mr. MCHUGH. The Chairman has a thing about produce, which I commend him for. I have got a thing about Diet Coke. More importantly, I have got a thing about something they call Coke Lite that they foist on those poor Europeans and other people as a substitute for Diet Coke, and it stresses me greatly when I think about the lack of Diet Coke and the presence of Coke Lite in commissaries and exchanges overseas, which brings us to Second Destination Transportation. See, there is a method.

I have been assured repeatedly by our folks, as they look at the budget numbers, that the Second Destination Transportation is going to be fully funded. Mr. Secretary, I always like to have somebody on record assuring me of that.

Can you assure me that SDT is fully funded by the Department—by the Army, I should say?

Secretary DOMINGUEZ. The Fiscal Year 2008 President's Budget submission, we got that fully funded, so that was not the case in the prior budget, and we corrected that for this year.

Mr. MCHUGH. Well, I am glad, and I am glad to have it on record particularly, and I appreciate that.

Mr. Secretary, you may have heard—well, I will just pose it in a different way. You know, we have heard about the dividend, and we heard about, I guess, 136—no—$221 million dividend by AAFES over the 2006, I believe it was, fiscal year. That dividend is critical to the entire effort.

How does that play out over time as we draw down particularly overseas? Has anybody had a chance to try to quantify that and to try to accommodate for that? I mean, clearly, the overseas customers have always been the system's best customers. I believe, at one time, they provided well over 50 percent of all of the revenues,

and it follows that that is a huge part of the dividend. That is so important in providing MWR programs.

So what does that look like—see, you were not talking this time, General Essex.

Secretary DOMINGUEZ. He was anxious to talk.

Mr. MCHUGH. He anticipated your answer.

What kind of read do you have on that issue?

Secretary DOMINGUEZ. Sir, right now—I mean, for the last several years, the dividends in aggregate across the exchanges have been declining, so they are under some significant pressure. It was in response to that that this Unified Exchange Task Force got started, and we really dove in with the Exchange Boards of Directors in exploring the concept of what kind of cooperative efforts we can do to drive down costs and, you know, to ensure the exchange profitability. So those things continue because the dividends will be under pressure for a while. The same things that are impacting the commissaries are impacting the exchanges with pension costs, construction costs climbing, the challenge of BRAC and restationing.

Mr. MCHUGH. Is there a budget estimate? I do not know if you can get to that level of projection, but as you look into 2009, 2010, et cetera, do you have a budget plan that says, well, we expect, by that time, the dividend will be $190 million or $200 million, or have you just not been able to forecast out that far?

Secretary DOMINGUEZ. Yes, sir, we do. I mean, each of the exchanges does with their boards of directors, you know, look at where things are going. I do not have that with me right now. I think each of them could talk to you about it, but we are and remain concerned about, you know, the downward trend and reversing that downward trend, and that is where a lot of our focus has gone.

So let me go ahead and turn it over to Paul.

General ESSEX. Thank you, sir.

Yes. I mean, you have identified one of the key reasons why dividend is changing. The move from Europe is anywhere from two to four times as much is spent by our customers when they are overseas in their exchange as when they come home, and then when they come home, they typically live off the post or off the base, so they pass two Wal-Marts, a Target and a strip mall before they even get to the gate, so it is going to affect our earnings. The other factors that are involved here are that it is not just the people moving and spending less, but when we have identified a place for closure, we have to start accelerating the depreciation schedule and finish that up by the time we close. So that adds to the issue. It is a temporary issue, but it is real, and gas sales and the whole gas business has been a change, too. Just 2 or 3 years ago, profit margins for us were 12, 13 percent, which is not great, but it is a benefit to the troops, and it was a fairly reasonable number. Now, even though sales on gasoline are way up, earnings are around five or six percent, so that has affected the earnings picture. Also, investment in the capital program at gaining bases where we have to build new stores has caused, you know, us to use a lot of that money in the 2006, 2007, 2008 time frame, and then, of course, as soon as you open a new store, you start the depreciation schedule again. So 2006–2007 has been sort of the perfect

storm year where a lot of these things have come together. We expect 2008, when we start really getting some benefit from our Retek Oracle Retail implementation to kick in, 2008 dividends should start coming back up nicely and proceed on up.

Mr. MCHUGH. Thank you.

Admiral COWLEY. Yes, sir.

Our profit demographics or revenue demographics are a little bit different than AAFES. We did not have quite the same decline in overseas revenue and we experienced stronger performance overseas. In fact, we have seen some increase in overseas revenue with the exchange that we opened in the Kingdom of Bahrain that was previously a ships store. Since we have opened that, we have seen some increase in revenue due to that. Oddly, we have all of the same pressures that my colleagues have articulated here, and we are looking both internally and externally at initiatives that we can pursue in order to mitigate that. If we look on our operating profit from 2003 on, it has been fairly steady. It has been health care, medical care. It has been some of the recapitalization. If you look at the pressure just in construction alone, it is fairly illustrative. We are seeing some increases, double-digit, 25, 30 percent that is not generating commensurate benefit on the other end. So we are looking both within and across organizations to continue to drive those efficiencies and economies through standardization in order to put us back on that upward slope. We have now deployed and are operational with our Oracle Retail, and indeed, we are seeing some benefit accrue from that. But as you know, that benefit accrues on a curve, and that comes a lot more slowly than does depreciation, so some of these other pressures affect us, and I believe we are on an upward trend.

Mr. MCHUGH. Thank you.

Mr. DOWNS. This is one of those cases where size and location matters. The Marine Corps is not dramatically impacted by other BRAC or restationing, and we only have one overseas store. You will note that our dividends were up 34 percent from last year to this year. We anticipate being able to sustain that. This is a particular case of, we started later in efficiency initiatives than the other exchanges, and that is just now coming into fruition. We will have some minor impact from the fact that there are some stores that lose sales during the periods of renovation, and we are on a very active renovation initiative, but we do not anticipate a significant lowering of our dividend, and we will, in fact, remain steady out to the foreseeable future.

Mr. MCHUGH. Thank you, gentlemen.

Thank you, Mr. Chairman.

Dr. SNYDER. Mrs. Drake.

Mrs. DRAKE. What about Mr. Kline?

Dr. SNYDER. Well——

Mrs. DRAKE. Okay. Do you want me to go first? Okay. Well, thank you.

First of all, Mr. Chairman, I want to tell you our pilot program on produce is working as well as Mr. Nixon has said. Customers are happy. Suppliers are happy. And it is really beautiful. It is well displayed. It is a good selection and just really working very well, and so I know we would like to see that everywhere, Mr. Nixon,

but two of the other things that we have talked a lot about in here and certainly the one Mr. McHugh asked about, about secondary destination, is my term. In my time in Congress, we have talked about produce, secondary destination, but there are two other things, and one is the DOD is looking at eliminating restrictions on the sale of certain other products, whether it be jewelry, furniture, what the status of that is. Then the second question would deal with implementing shared services, kind of backroom for the separate exchanges—human services, logistics—an update on all of that.

Secretary DOMINGUEZ. Let me start with the latter on the shared services.

What we did as part of our discussion of the Unified Exchange Task Force is we recognized that the boards of directors for each of these exchanges has a fiduciary responsibility to their stakeholders to ensure that this dividend that we just talked about is sustained, and the Unified Exchange Task Force pointed out areas through, you know, shared purchasing, the potential for some shared human resources (HR) services, for some shared information technology (IT) services, those kinds of things, where costs could be reduced through economies of scale, and what we agreed was that we need to look at each of these individually as a business proposition and that the exchanges should develop mutually agreeable business proposals that would be vetted with their directors so that they then commit themselves to it because of a compelling business need. So we have really put this back to the boards to let them guide the way forward here, again, keeping our eye on that dividend ball. I am sorry. The——

Mrs. DRAKE. Specialty items. Furniture.

Secretary DOMINGUEZ. As a general proposition, we would like for the exchanges not to be restricted around the sale of some items. Again, that helps their ability to meet customer needs, generate revenues, profits and then MWR dividend. Saying that, we recognize that there are particularly issues with small businesses, in particular outside of our gates, and we have to be good stewards and citizens of the communities, you know, in which we live, but we are reviewing that continuously with an eye to try and lift restrictions wherever that is possible and that it makes sense and will not disrupt the community where we belong.

Mrs. DRAKE. Thank you very much.

Thank you, Mr. Chairman. I will yield back.

Dr. SNYDER. Mr. Kline.

Mr. KLINE. Thank you, Mr. Chairman. I was not going to speak because I, unfortunately, came in late, and I am always hesitant to ask a question that has been covered probably three times by every member and every witness.

Dr. SNYDER. It does not stop the rest of us.

Mr. KLINE. I know. I remembered that, Mr. Chairman, and thought, what was I thinking?

I just wanted to say a couple of things and get to one question that is always nagging out there for me. First of all, let me say that the reports that I have heard about the commissary and exchange system continue to be good. I have my built-in spy system. My son is serving on active duty; his wife goes to the commissary

and the exchange at Fort Campbell, Kentucky, and I continue to get good reports. And so I always check that barometer on how things are working; I am glad to hear that.

One of the things that continually comes up is of some concern to me and, I hope, to you. When we have troops deployed in relatively small numbers, typically to remote corners—Admiral, you mentioned Bahrain, but we have troops in Djibouti and Iraq and Afghanistan and all sorts of places—where they are set up for sometimes several weeks or several months, we need some sort of exchange system, and that has worked pretty well.

In the past, there have been problems getting sort of essential items, small, round, circular cans of smokeless tobacco and things like that. I am just saying that I hope that we have foreseen our way through that and are able to get that kind of essential item to these troops in these remote corners. And I ask any of you if you are getting any feedback that there is difficulty there. I wouldn't expect from this group that you would.

General ESSEX. Sir, we watch that stuff closely; that is, job one at the Army and Air Force exchange service is the support to our deployed troops, Operation Allied Force (OAF) and elsewhere, as you mentioned, in various locations. And we pay particular attention to that. I have a senior vice president in my area staff that focuses on that.

For the small locations out in the more remote parts of Iraq, for example, we typically use what are called impressed fund operations; that is, where someone in that small unit will actually go pick up tobacco, toothpaste, whatever they are going to take back and we give them a credit account and they sell it and then once a month or once every couple of weeks, depending on how often the need, they come back and replenish.

That said, as hard as we try, sometimes we do run out of some particular item at certain locations. The logistics are a tough, tough problem in some of these places. And we watch it as closely as we can and do make it a major focus.

Mr. KLINE. Exactly. It is the logistics that are almost always the issue.

We have enormous demands on intratheater lift in Iraq. I know that you are very much aware of that. But intertheater lift, we have had instances in my ancient history where we couldn't find the transportation or you all couldn't find the transportation to get the items there; and that is what I was going to.

Are you running into that? Are you hearing sorts of things that you can't get, some of these high-demand items, to the more remote corners?

And I am thinking certainly there are some forward operating bases (FOB) and things in Iraq, but I am also thinking of places like Djibouti and Bahrain and places that don't have the focus and may not have the continuing flow of the lift.

General ESSEX. I can't say that we are perfect. We try and we do watch it closely. Occasionally things pop up where we run out of something, but we push hard to get everything replenished as quickly as we can.

And we hear—with the e-mail age here, the troops are pretty well connected and they let us know.

Mr. KLINE. Thank you very much.

Thanks, Mr. Chairman.

Dr. SNYDER. Thank you, Mr. Kline.

I wanted to ask Mr. Nixon one more. I can't let go of produce. One of the issues from my last visit out there, for want of a better term, it is "specialty items," where you have, let's suppose, some kind of item that is good for perhaps ethnic cooking or it has got a little niche consumer base.

I was discussing with, I think, the produce manager there about the issue that if something—if you buy in certain volume, if you buy 20 of something, but you only sell three packets, it does not take you long to figure out that is a loser and so the response may be to cancel the item.

How do we deal with that—that situation? Is the problem, too many were being shipped from your wholesaler? Or is that an issue that has come up? I assume that is an issue that has come up at other places.

Mr. NIXON. In particular, with the produce manager there; and having come from a smaller location—she came up from Key West—one of the things that we stress in our operations, especially the ones that are perishable, is accountability and they have to recoup the amount of money for the markup for processing, whether it is meat or whether it is produce.

One thing I challenged her, and also challenged Mr. McDonald, is that, you know, when a produce market will carry—a full-range produce market will carry 350, 400 items and they were carrying probably 250 there. And in talking with store management, I said, let's be aggressive, and if the packs are too big, let's work with the produce company.

The MPG group has all military commissaries on the East Coast except the ones protested in the Northeast. They certainly have enough volume to stretch a little bit. And I said, let's stretch and let the customer decide. If there is a pack issue, worry about that.

Bridget Bennett, our produce specialist for the East Coast, added 50 items while she was there. And some of the items she added only were shipped the first time, and the supplier wasn't ready for the orders.

But there are folks who are willing to experiment with produce, and let them decide. And price wise, too; we always want to be price conscious.

The things that I noticed when I went down there, we are bringing the oranges and grapefruit in from Texas, and from an appearance standpoint, they worked with the best. But they were the ones that were competitive with what was being sold out in town.

I say, bring the top of the line, and if it is a dollar an orange, let the customer decide. If they want to pay a dollar an orange, we will sell them an orange. And that dollar will be 50 cents cheaper than out in town, if they carried it.

From the aspect of getting new, what you call "exotic-type" items, it is up to our managers to stretch and our suppliers to bring them in. And we can work with the packs, and work with the growers, and say, look, I can't take a 24-pack on that. I want you to start going to a 12-pack. We can start moving some of these items in multiple items. That is what we did and what we are going to do.

Dr. SNYDER. And those are some of the issues that are continuing to evolve under this new way of supplying produce; is that correct?

Mr. NIXON. Yes, sir.

Dr. SNYDER. Mr. Dominguez, I wanted to ask you, have you reached any conclusions or have opinions on whether there should be insurance on exchanges or commissaries? I think there was an ongoing study about how you see the status of that.

And the second, is with regard to beer and wine sales at, potentially, commissaries as a way of dealing with this potential shortfall on the five percent surcharge.

Secretary DOMINGUEZ. Sir, first, with respect to insurance, the exchange commanders are still looking at that. It is actually quite a complicated challenge to look at the risk profile everywhere they are, and then the availability of insurance products and the affordability of those products.

So they are still working their way through that. I am going to refrain from issuing an opinion until after I have seen their studies and get the advice from their boards.

On the beer and wine sales in the commissaries, I think if I was to put these two problems, the MWR dividend and Mr. Nixon's challenge, on the scale and weigh them with the beer and wine, my opinion is, beer and wine comes down on the exchange side, on the MWR dividend side.

I am not nearly as sanguine as these gentlemen are about our ability to turn that dividend growth—or that decline back into growth. And I certainly wouldn't want to erode their ability to generate that MWR dividend through this very highly profitable line of business that they have there.

I think I accept the challenge Mr. Nixon has with that five percent surcharge having been created in a different era. But if we tackle that problem, I would like to do that without putting in jeopardy the MWR dividend.

So those are my thoughts on the beer and wine.

Dr. SNYDER. Mr. McHugh.

Mr. MCHUGH. Thank you, Mr. Chairman.

Mr. Secretary, I would like to go back to Mrs. Drake's question about Armed Services Exchange Regulation (ASER). I heard what you said and I appreciate that. Outside-the-gate sensitivity is certainly something that those of us on this subcommittee and, in fact, the entire committee in Congress share. As you know, the House, however, has approved some relaxing of restrictions in the past—last year included, I believe—that the other body, as we say, did not totally agree to.

Do you know of any—well, are you attempting to talk to the Senate to see what receptivity might be for future relaxation? Or what is the status of that? Is there anything you can share with us there?

Secretary DOMINGUEZ. It is an issue. I have not yet engaged with members of the Senate or their staff on this. But my staff has, and I know the staff of these gentlemen have, because there are clearly important business opportunities that are important to generating and sustaining that MWR dividend that they are being precluded from pursuing. And some liberalization of those restrictions, I

think, would be important; and we will engage and continue to push.

Mr. MCHUGH. So it is a live issue, I guess?

Secretary DOMINGUEZ. It is a live issue.

Mr. MCHUGH. Rather than just a broad-based study?

Secretary DOMINGUEZ. No, sir. There are some specific product lines they will talk to you about that we would like for them to be able to get into. We see no reason why they should not be in there. And it will be important, in my judgment, in ensuring and guaranteeing their profitability both by drawing in customers and by selling products that are in demand, that will generate a profit margin.

Mr. MCHUGH. Okay.

At least 10 years ago—and I don't have my biography in front of me; it may have been 12—I had the honor of serving as MWR Chairman. That was an independent panel prior to the reconstruction of this Personnel Subcommittee that brought MWR back under our jurisdiction. MWR was all we did.

At that time we were talking about back office cooperation, shared efficiencies, where can the exchanges work together? That was 10 years ago. We are still talking about it.

Can you tell me what exactly has been done with respect to cooperation, other than talking about it? Talking is great, but when are we going to do something?

Secretary DOMINGUEZ. I believe that there has been actual progress——

Mr. MCHUGH. Good.

Secretary DOMINGUEZ [continuing]. Through the forums that we have set up. And what I would like to do is refer to the gentlemen here. Why don't we start with the Admiral.

Admiral COWLEY. As the current chairman of the Cooperative Efforts Board, we have done a number of logistics initiatives; and today we are taking a very programmatic approach and looking at discrete milestones and business case analyses so that we can go back and report to our board of directors vis-a-vis our fiduciary responsibility.

We have a number of initiatives that we are pursuing with AAFES that are very well along. The nonretail procurement, we are very well along on that. We have established commodity councils. We are using community analogs.

We are not making this up as we go along. We are looking at what works in the commercial sector and we are pursuing that.

The long pole in this is the IT backbone, and we currently have an initiative in place right now where we are looking at mapping that IT backbone. And it is not just information technology; it comes down to the business process level. In order to make a lot of this stuff actionable, you have to be able to translate it down to the business process level.

It is a detailed process, but we have undertaken that effort and we are not going to wait until we get nirvana out here. We are actually looking at how to capitalize on different opportunities, as we discover these in the process as we move along. So I think we are making pretty good progress there in a number of these areas.

And, in addition, I know within Navy we are looking at consolidating some of our backroom functions with MWR. We are now looking at some of the quality control and the audit functions there, as well as some of the retail functions where we can reach across and operate more effectively and efficiently.

Secretary DOMINGUEZ. Sir, maybe General Essex can talk to you about the gift card, which is a new product that the exchanges have brought on line.

General ESSEX. That is one of the four cooperative efforts that we have tackled this past year. And it is the one that is going to pay off first.

It seems like a small thing, but it is actually quite a big thing from a customer perspective; and it was a request of the Marine Corps and Navy Exchange that we tackle this. And it is simply that if a family or troop wants to buy a gift card at a Marine Corps exchange, that they would be able to cash it in at an Army and Air Force exchange or vice versa.

And as Admiral Cowley pointed out, business processes and IT had made that a problem. We have had three different size companies over the years, as you know, with different business practices because of that, and different IT. So it is very encouraging what we are doing.

I think it is exactly the right thing. The gift cards is a good step in the right direction, and certainly the logistics and the indirect procurement and the information technology are going to pay good dividends for a long time.

Mr. DOWNS. Congressman McHugh, I testified in front of that MWR panel when Congressman Martin was the ranking member. But it bothers me that we allow the thought out there that exchanges haven't been making real progress and efforts within the cooperative efforts for many, many years.

The Marine Corps exchange has lived off of cooperative efforts with the AAFES and Navy Exchange Command (NEXCOM), as far as I can remember; and perhaps we haven't spoken to that enough, but there have been 70 or 80 cooperative efforts that have been on the books between the various exchanges for multiple years. And we just don't seem to get credit because they are not big banner items. They are not big bang items, but they are, in fact, things that allowed us to incrementally do things more efficiently and effectively.

Mr. MCHUGH. Well, I appreciate that. Let me tell you why it is important, and maybe you should start tooting your horns a little bit louder.

The fact of the matter is, Admiral, the reason that is the long pole, that is the hardest, I think—I understand that—but that is also where the biggest savings potentially lie. And, remember, don't forget, why this is a point of interest and concern: Because the Department at one point was talking about outright exchange consolidation, and the Congress did not want to do that. But Congress felt the responsibility to ensure that you worked very proactively to derive some meaningful savings; not that savings in other things aren't good, but we are talking about backroom operations and such.

What worries me, and I am not trying to put the bean on Secretary Dominguez, but we will all pass away from this place and do other things with our lives; and in another time someone in his place is going to come in and say, we are going to consolidate, again because they people did not do what you challenged them to do.

That is why I worry and that is why I think the question is important. And I certainly want to encourage you to continue to work as hard as you possibly can to get the long pole up and do as much as you can, so we don't have to be dealing with consolidation.

And the other things that I think are problematic in recognizing that you all have your legitimate cultures, there are differences amongst your various customer bases that I think legitimately need to be reflected in what you do. And that would be greatly jeopardized, in my judgment, with consolidation, outright consolidation. That is the purpose of my question.

With that, Mr. Chairman, I guess the red light is on. You got it fixed for me. I yield back.

Dr. SNYDER. Mr. Murphy.

Mr. MURPHY. Thanks, Mr. Chairman. As a former soldier myself, I know how important the MWR is to accomplishing the mission. In fact, in the 82nd Airborne Division, we used to say the heart of the soldier is more important than the body of the soldier. One of the most critical things for a soldier is that peace of mind while serving his country overseas to know that his family is being taken care of.

I am very concerned about the decreasing exchange dividends, a problem which appears to be prevalent across the services, though most notably in the Army and Air Force exchange systems. The dividends from the exchange services fund about 16 percent of the MWR programs. These MWR programs fund critical things for military families such as child care centers, e-mail, phone access so families can communicate with their soldiers overseas, and a wide range of other programs.

So I looked at numbers, the profit, the dividend ratio, with 55 to 60 percent of the profits going to fund MWR dividends. If we continue to see declining profits in the exchanges, would it be possible to increase the percentage of profits that go to MWR dividends? And if we did this, what other programs or areas might lose out?

Secretary DOMINGUEZ. Sir, let me take that to start with.

We all share your concern, and I think before you got here, you heard, or the committee heard, each of the exchange commanders testify to their optimism that the decline in MWR dividends will be, in the years ahead—near years, not distant years—near years ahead will turn around and they will start growth again.

I have extraordinary confidence in their management and leadership abilities. It is something that we do need to watch.

The right attack on the problem, I think, is through cost containment, which is, again—some of these issues that Congressman McHugh was asking about where you consolidate back office operations and try and reduce overhead costs are contributors to that. It is also through the expansion of new products and new product lines and new methods of delivery.

So these gentlemen are all into using the Web now, and we just talked with the committee about easing some of the restrictions that now they have that keep them out of some business lines.

And the other challenge is going to be closing facilities where the bases are closed, where there isn't the business anymore that generates revenue and, in fact, where we are actually hemorrhaging. That is a big challenge for us.

The big challenge in trying to work cooperatively with the commissary so that the two entities can draw customers in and increase foot traffic.

And so all of those things are now going on. And it is through those mechanisms that I think we will be able to turn this direction around.

Mr. MURPHY. And I understand what you are saying, and I understand that you are optimistic about how you can could do that. But my question, if you can't turn around and if you see the profits continuing to decrease, would you change the dividend ratio? Because right now it is 16 percent MWR funds from you, and I want to make sure that these soldiers getting taken care of and these Marines and airmen.

Secretary DOMINGUEZ. The only way we can do that in the exchanges is to put further pressure on their recapitalization. So that is not a good long-term strategy.

Mr. MURPHY. But what window are we talking about here? My concern is, I want to make sure that these MWR programs that are directly affecting soldiers that are serving overseas in deployments are being taken care of. Is there a look at changing this ratio if you can't hit it in the short term, and what is the short term? Quarterly? Are we talking annually?

I want to make sure that these MWR programs are not getting shortchanged.

Secretary DOMINGUEZ. Right. I share your concern with that.

We do have the ability to fund, and we do fund directly in the MWR programs with appropriated funding. So if the dividends diminish to such a degree that some of these essential programs—as Congressman McHugh said, those are readiness; they affect readiness, they affect retention. So these are critical programs. And we would first look at increasing the amount of appropriated funding we are giving to the different MWR categories.

Another challenge, and we talked to Congressman Snyder about this, is that our construction recapitalization programs right now are authorized to be funded through appropriated funds, through the BRAC and the global repositioning. We were unsuccessful in making that case inside the Department so that—there was not enough money to go around, and we drew the line, so these are now being funded out of the profits the exchanges generate.

That again is a continuing debate we need to have. We need to keep that issue on the table and in front of decision makers, particularly if we start to see the support to the MWR accounts erode. Then that balance may tip and these projects may get above the line in terms of the BRAC construction accounts.

So you are exactly right, exactly right to focus in terms of watching that dividend. And there are a lot of things going on to try to protect that.

General ESSEX. Sir, if I could add one point to that that you could do.

Mr. MURPHY. It is up to the chairman.

Dr. SNYDER. We would like to hear your comment. You will have another opportunity, Mr. Murphy, if you need it.

General ESSEX. Just to add one more point to that, when AAFES operates overseas in contingency areas, we have extraordinarily high operating costs, sometimes, which we are reimbursed for. Last year, the Congress did reimburse almost the entire amount; it was $80 million that we were authorized. And it has not always been that way in the past, but last year it worked out.

In the future and this coming year, we will have extraordinary expenses that are authorized for appropriated funds. If those are provided, then it goes to the bottom line and that goes to the dividend.

Secretary DOMINGUEZ. And that is through the supplemental process.

What he is talking about is direct support to soldiers, sailors, airmen, Marines engaged in combat.

Mr. MURPHY. Last year it was 80 million. This year it is what?

General ESSEX. We won't know yet.

Dr. SNYDER. Mrs. Davis.

Ms. DAVIS OF CALIFORNIA. Thank you, Mr. Chairman. And, as usual, I am doing double duty with other committees.

I appreciate that you are all here, and I am sorry that I missed your earlier testimony.

I wanted to mention, because I think it is so important to the San Diego area—and I appreciate, Mr. Nixon, your work on this—that we do have—we will be opening, actually, a 118,000-foot commissary next month. And that will have some unique features, so that families can come—if they want to convenience shop, they can do that; and if they want to fill their pantries, it is a different kind of shopping in a different area that they will be engaged in.

We think this store within a store is going to be very important. And I appreciate some of the decision-making that went into that.

I don't know if you want to comment on that, Mr. Nixon, in terms of how you got to that point, and whether or not that is a model that really should be tried elsewhere in the country and if we are going to be look at that.

Mr. NIXON. Yes, ma'am. Actually, we went out and did significant market research and brought a consultant in to find out what were the shopper-of-the-future's requirements going to be. And they surveyed all the leading retailers and said, you are going to have to meet two particular shopping demographics, a convenience shopper and a pantry-building shopper. And how to do that? You build a store within a store.

When you go into the store of the future, you go into a convenience-type store environment to get that day's meal—get in, self-check out—get in and out. And we will have short-term parking, and we put it on the side where the barracks are going to be.

If you are going to do the pantry-loading shopping, you go in the other entry. The line of demarcation is the frozen foods. That is convenience and pantry-loading. We have set a goal to be the nutritional leader in the supermarket industry, so we are putting in an

extensive organic and health and wellness section associated with a huge produce section, the largest meat department in the world.

Incredible, incredible opportunities and some additional technological futures like a new front end system. The self-checkout counters, being able to order through kiosks, place an order and go pick it up in the deli or bakery later on.

We did extensive research. This is the model we will use, but it has to be tailored to the demographics of the particular base. Our goal in the naval station store is to have the largest commissary in the world, but an individual shopping experience. And that really is leading edge in the supermarket industry.

So if we can accomplish that——

Ms. DAVIS OF CALIFORNIA. Thank you. I appreciate that. I guess the one thing we are going to want to evaluate as we look at that is whether it makes for more affordability for families, as well, whether they feel that they are going to go in. What we don't want probably—and we all experienced this in Costco—is a lot of impulse shopping, so that families find that their budgets don't go as far as they would like them to, and so that they can really focus on what is most nutritious and affordable and help them out through that impulse.

Mr. NIXON. We allow them to go on www.commissaries.com and do their shopping list while they are at home so they are not tempted by the impulse items. They may see one item they can't pass by, but for the most part we allow them to do the shopping experience in their home and bring that list with them.

Ms. DAVIS OF CALIFORNIA. Is there also an opportunity in that for families within a certain distance, that they can have deliveries if they shop on line?

Mr. NIXON. We have looked at that option and we are evolving the virtual commissary. Right now, it has gift packs—very successful. Our sales per visit to the virtual commissary mirror what happens in the private sector. It is primarily gift packs now. We are hoping by summertime, we will have around 200 items on sale, like Amazon.com has groceries for sale, for a shipping fee.

We haven't talked about the delivery mechanism, but we will once we make sure that we have the mechanism in place to order on-line.

Ms. DAVIS OF CALIFORNIA. Thank you.

And getting back to my colleague's question, what we want is to be able to serve our families, our military families, and to be able to return to them their investment in their shopping experience as well. And as we have some extraordinary services that I hope you will be providing there, how do we monitor that so that we are able to capture those best practices, whatever you want to call it, and see whether or not it is making a difference in terms of MWR and whether or not they are really getting that return?

Are you all going to be looking at that? How are you going to be doing that?

Secretary DOMINGUEZ. We survey customers to ensure that the quality of their experience meets or exceeds industry standards. And so we do the surveys. And someone up here mentioned that these are contracted out to a group that does this in industry. So that is important.

Through the efforts of the boards and through the exchange cooperation, we are continually looking at benchmarks against our competitors in terms of practices and profitability and those kinds of issues. It is a continuing obsession with these leaders here and their boards of directors.

I hope that answers your question.

Ms. DAVIS OF CALIFORNIA. Just quickly, Mr. Nixon, do you expect the revenues to jump by any measurable degree at the stores?

Mr. NIXON. Since we are not directly involved in generating MWR dividends, we expect sales to increase significantly. In fact, our largest volume commissary is Fort Belvoir, doing around $92 million a year. We think the naval station could be the first $100 million commissary. The significant funds generated will be to surcharge the patron's dollar, to go back and recapitalize other investment opportunities.

Absolutely. This was built—we do charrettes; we ask the patrons what they would like to see in it, and that is what we put in it. We monitor, as the Secretary said, their shopping experience to make sure it is world class, because they deserve it.

Ms. DAVIS OF CALIFORNIA. Thank you. We are excited.

Dr. SNYDER. Mr. McHugh and I will both have questions for the record which we hope you all will respond to in a timely fashion, but I wanted to give Mr. Murphy and Mrs. Davis any opportunity for questions they have today.

Mr. MURPHY. I just want to make sure, from my understanding of the timing issue when we talk about the dividend ratio. Do you make that decision on an annual basis?

Right now, 16 percent; it has been about 16 percent that you fund MWR. If we continue to see a decrease in profits, when do you look at that? And I understand you are optimistic.

Secretary DOMINGUEZ. Well, first, these decisions are made by the individual military services in consultation with their boards as they are looking at their exchanges annually. That is annually.

Mr. MURPHY. How about this fiscal year? When are we looking at this?

Secretary DOMINGUEZ. This fiscal year, the aggregate—again, that is, in aggregate—the situation is different by individual exchange, but in aggregate the MWR dividend is smaller this year than last.

I think we are looking at 2010 or so to really to have that begin to turn around again; that is, in aggregate, the individual exchanges have different pictures each.

Mr. MURPHY. Would each you like to comment?

Admiral COWLEY. I guess it is true each of our boards do establish targets for us that we meet. Ours is established annually and we report performance to plan on a quarterly basis.

One thing I would like to say is, as we look at this, it is established based on requirement. Looking at it, year on year, in terms of consumption does not necessarily tell the whole story. As we are looking at reductions in active duty population and whatnot and what the actual requirement is out there, that is what the board looks at; and our boards look across both MWR and the exchange and balance across the two of them.

There may be one year where there is emphasis in one of them and one year where there is emphasis in another. Without looking at that granular level, just looking at a top level does not tell the whole story. We really look at the discrete requirements in the MWR categories as well as the savings that we are providing to our customers when they come in the stores, our recapitalization. That is the dialogue that goes on in our board meetings, and they meet quarterly.

General ESSEX. I can speak for the Army and Air Force Exchange Service. The number we use—and I believe our numbers are correct—is, 65 percent of our earnings goes to the dividend. It is split between the Army and Air Force, but also Marines and Navy because we operate exchanges on Okinawa, Marine bases, but we operate the exchanges and provide the dividend to them.

And then, of course, there is the split for the earnings that come from Internet sales and cataloguing we do cooperatively. So two-thirds are dividend, one-third capital program.

The best advice we have from industry and academia says that basically taking money from that capital program will have a very negative, long-term impact and the strong advice is against doing that.

One of the things that we wrestle with every year in our board meeting, where we discuss our annual financial plan, is this very issue. And one of the problems we have is that we are, like any private company, required to follow generally accepted accounting principles, or GAAP, and that requires that we do deal with depreciation just like a private entity does.

And when I was talking earlier—I don't remember if you were in yet—but I was trying to explain in 2006 and 2007 is kind of a perfect storm year for us where we have a lot of capital programs, due to BRAC, and a lot of depreciation that comes with that. And then the closing bases with BRAC and global restationing cause us to do accelerated depreciation.

That also impacts our dividend; and hence, my point that I keep, you know, probably exaggerating, but make as strongly as I can, that any time there is an appropriated fund authorized, then it does make a direct impact on the MWR dividend if it can be actually appropriated, instead of making us use the soldiers and airmen nonappropriated money that is generated from sales.

Mr. MURPHY. Thank you.

Dr. SNYDER. Anything further, Mr. Murphy?

Mr. MURPHY. No, sir.

Dr. SNYDER. Gentlemen, we appreciate your being here today, and we appreciate your comments as we head into this year's Defense Bill. The hearing is adjourned.

[Whereupon, at 11:45 a.m., the subcommittee was adjourned.]

A P P E N D I X

MARCH 13, 2007

PREPARED STATEMENTS SUBMITTED FOR THE RECORD

MARCH 13, 2007

Opening Statement Chairman Snyder
Hearing on Overview of Military Resale Programs
March 13, 2007

Today the Subcommittee will turn its attention to military resale stores….the commissaries and exchanges.

These stores are the pillars of the military community that provide vital products and services that not only contribute to the quality of life of service members and their families, but also to the cohesiveness and morale of the community that is so important to troop morale and ultimately combat readiness. During war, nothing is more important to our warriors than the comfort of the knowledge that the welfare of their families is secure.

I commend everyone engaged in those operations and particularly the people seated at the witness table as they all bear special responsibilities in the good works of our exchanges and commissaries.

There are challenges confronting these important activities and this Subcommittee will continue to be an advocate for exchanges and commissaries and a leader in finding the solutions that are needed. Some of the concerns of the Subcommittee include the military resale operations at base closure sites, reduced exchange contributions to morale, welfare, and recreation programs, and adequacy of funding for construction programs.

Mr. McHugh, did you have any comments.

Let me introduce our panel.

Honorable Michael L. Dominguez
Principal Deputy
Under Secretary of Defense for Personnel and Readiness

Major General Paul Essex, USAF
Commander, Army and Air Force Exchange Service

Rear Admiral Robert E. Cowley III, USN
Commander, Navy Exchange Service Command

Mr. Patrick B. Nixon
Director and Chief Executive Officer
Defense Commissary Agency

Mr. Michael P. Downs
Director, Personal and Family Readiness Division
Headquarters, United States Marine Corps

Opening Remarks – Rep. John M. McHugh
Military Personnel Subcommittee Hearing
Overview of Military Resale Programs
March 13, 2007

Thank you Dr. Snyder.

Our witnesses today lead the military organizations and activities that are the proverbial heart and soul, the sinew and bone, of the quality of life programs and benefits so crucial to sustaining the all volunteer military.

As evidenced by the written testimony submitted for this hearing, these leaders and their organizations have been amazingly successful in satisfying customer expectations, providing patrons substantial savings and quality merchandise, generating dividends for MWR programs, accommodating organizational and financial challenges, and finding efficiencies while modernizing and streamlining operations.

Just to cite one example, I want to highlight the comment made in Pat Nixon's statement about DECA, the Defense Commissary Agency. It reads: "When measured in constant Fiscal Year 2000 dollars, the administration of the commissary benefit today

continues to remain below what it cost in 2000....[and] the reduction...in cost has been gained—not at the expense of our customers—but because of the efficiencies developed and deployed throughout the Agency....[Customer satisfaction] continues to be higher than the commercial supermarket national average."

Similar accomplishments could be cited for each of the exchange systems. And my hope would be that future successes could be gained by continuing to rely solely on the intelligence, creativity and business acumen of the current and future leaders of the commissary and exchange systems.

Hope, however, has never been a strategy and as our witnesses today well understand there are several significant challenges coming together that must be addressed if the commissary and exchange benefits are to be sustained. Collectively those challenges – including BRAC, global rebasing, pressure on appropriated fund support, skyrocketing construction costs, commercial competition, declining MWR dividends, extended operations in a wartime environment – if left unaddressed will fundamentally

alter the roles of the commissary and exchange systems in the overall quality of military life.

So, Mr. Chairman, I look forward to our discussions today, and continuing to work with you to sustain the commissary and exchanges.

WRITTEN STATEMENT

BY

MICHAEL L. DOMINGUEZ

PRINCIPAL DEPUTY UNDER SECRETARY OF DEFENSE

(PERSONNEL & READINESS)

BEFORE THE

SUBCOMMITTEE ON MILITARY PERSONNEL

OF THE

COMMITTEE ON ARMED SERVICES

HOUSE OF REPRESENTATIVES

ON

MARCH 13, 2007

Not for Publication until Released
By Committee on Armed Services
U.S. House of Representatives

Michael L. Dominguez was nominated by the President as the Principal Deputy Under Secretary of Defense for Personnel and Readiness on November 21, 2005 and confirmed by the Senate on July 11, 2006. As a presidential appointee confirmed by the Senate, he is the primary assistant to the Under Secretary of Defense for Personnel and Readiness providing staff advice to the Secretary of Defense and Deputy Secretary of Defense for total force management as it relates to manpower; force structure; readiness; Reserve Component affairs; health affairs; training; and personnel policy and management, including equal opportunity, morale, welfare, recreation, and quality of life matters.

Prior to this appointment, Mr. Dominguez served, from August 2001 until July 2006, as the Assistant Secretary of the Air Force for Manpower and Reserve Affairs. His responsibilities included developing and overseeing Air Force manpower and personnel policies, readiness, and Reserve Component affairs.

Mr. Dominguez also served as Acting-Secretary of the Air Force from March 28, 2005 thru July 29, 2005. In this role, he was responsible for the affairs of the Department of the Air Force, including the organizing, training, equipping and providing for the welfare of its more than 360,000 men and women on active duty, 180,000 members of the Air National Guard and the Air Force Reserve, 160,000 civilians, and their families.

As an Air Force dependent, Mr. Dominguez grew up on bases around the world. After graduating in 1975 from the U.S. Military Academy at West Point, N.Y., he was commissioned a second lieutenant in the U.S. Army, reported to Vicenza, Italy, then worked varied assignments with the 1st Battalion, 509th Infantry (Airborne) and the Southern European Task Force. After leaving the military in 1980, Mr. Dominguez went into private business and attended Stanford University's Graduate School of Business. In 1983 he joined the Office of the Secretary of Defense as an analyst for Program Analysis and Evaluation (PA&E).

Mr. Dominguez entered the Senior Executive Service in 1991 as PA&E's Director for Planning and Analytical Support. In this position he oversaw production of DOD's long-range planning forecast and its $12 billion in annual information technology investments. He also directed the PA&E modernization of computing, communications and modeling infrastructure. He joined the Chief of Naval Operations staff in 1994 and assisted in the Navy's development of multi-year programs and annual budgets. Mr. Dominguez left federal government in 1997 to join a technology service organization. In 1999 he began work at the Center for Naval Analyses where he organized and directed studies of complex public policy and program issues. In 2001 he rejoined the staff of the Chief of Naval Operations where he worked until his appointment as Assistant Secretary of the Air Force.

EDUCATION

1975 Bachelor of Science degree, U.S. Military Academy, West Point, N.Y.
1983 Master's degree in business administration, Stanford University, Stanford, Calif.
1989 Program for Senior Officials in National Security, Harvard University

CAREER CHRONOLOGY

1. June 1983 - September 1988, program analyst, Office of the Secretary of Defense for Program Analysis and Evaluation, Washington, D.C.
2. October 1988 - September 1991, executive assistant to the Assistant Secretary of Defense for Program Analysis and Evaluation, Washington, D.C.
3. October 1991 - September 1994, Director for Planning and Analytical Support, Office of the Assistant Secretary of Defense for Program Analysis and Evaluation, Washington D.C.
4. October 1994 - April 1997, Associate Director for Programming, Office of the Chief of Naval Operations, Washington, D.C.
5. April 1997 - September 1999, General Manager, Tech 2000 Inc., Herndon, Va.
6. September 1999 - January 2001, Research Project Director, Center for Naval Analyses, Alexandria, Va.
7. January 2001 - August 2001, Assistant Director for Space, Information Warfare, and Command and Control, Office of the Chief of Naval Operations, Washington, D.C.
8. August 2001 - March 2005, Assistant Secretary of the Air Force for Manpower and Reserve Affairs, Washington, D.C.
9. March 2005 – July 2005, acting Secretary of the Air Force and Assistant Secretary of the Air Force for Manpower and Reserve Affairs, Washington, D.C.
10. July 2005 – July 2006, Assistant Secretary of the Air Force for Manpower and Reserve Affairs, Washington, D.C.
11. July 2006 – Present, Principal Deputy Under Secretary of Defense for Personnel and Readiness, Washington, D.C.

AWARDS AND HONORS

1980 Army Commendation Medal
1988 and 1994 Defense Meritorious Civilian Service Medal
1993 Defense Civilian Service Medal
1997 Superior Civilian Service Medal, Department of the Navy
1998 Meritorious Executive Presidential Rank Award
January 2005, July 2005 and July 2006, Air Force Exceptional Civilian Service Medal

Chairman Snyder, Representative McHugh, and Distinguished Members of the Subcommittee, I am honored to appear before you to testify about the military commissary and exchange programs.

The Department of Defense is committed to providing a high quality of life for military members serving our Nation and their families. We recognize that the commissary, exchange and morale, welfare, and recreation (MWR) programs have a profound impact on the quality of life of our military families. As the oversight of MWR programs will be covered on March 29th, my testimony today addresses Department of Defense oversight of the commissary and exchange benefits.

Before discussing those matters, I would like to thank the Subcommittee for its support in helping the Department advance the commissary and exchange benefits for our Soldiers, Sailors, Airmen and Marines. The collaboration between the Department and the Congress has ensured that the resale system keeps pace with the changes taking place within the Department, our society, and the business world. Your advocacy has delivered many of the authorities needed for the Department to become more effective in providing commissary and exchange benefits.

THE RESALE BENEFITS

The commissary and exchange programs are among the most valued contributors to the quality of life of our Service members and their families. Commissary and exchange programs are essential components of the military compensation and benefit package, and are important contributors to morale and readiness. Familiar products and services are made available at a savings as a benefit for our active duty members. In addition, these programs support mission activities around the globe. Finally, they provide a safe and convenient community hub, particularly in overseas areas.

THE RESALE SYSTEMS

The resale system is designed to meet the day to day needs of our Service members and their families and must be capable at all times of supporting our forces deployed throughout the world. The readiness of our military forces is dependent upon many things, including the systems that sustain our members and their families during deployments.

The Defense Commissary Agency (DeCA) operates a world-wide system of 263 commissary stores that sell name brand grocery and household necessities to military personnel and their families. The commissary system is operated entirely with appropriations and goods are sold at cost plus a 5 percent surcharge. This fiscal structure is designed to save military families an average 30 percent and produce $279 million annually to support capital investment in store systems and shopping facilities.

The Military Services run three world-wide Exchange systems that operate retail complexes on 297 military installations, catalogs, and web sites that sell a wide range of merchandise and services to the military community. The Exchanges also provide resale activities to support military missions on board 156 ships and in 58 contingency operations, including deployed locations and disaster relief areas. The Army and Air Force Exchange System (AAFES), the Navy Exchange Service Command (NEXCOM), and the Marine Corps Exchange (MCX) are operated predominantly with self-generated nonappropriated resources and with Military Service appropriations authorized for limited purposes. The exchanges price their goods to average at least 15 percent savings to the customer and to produce revenues at a level set by their Military Service to sustain exchange capitalization requirements and to help finance their MWR programs.

OVERSIGHT

The Secretary of Defense assigns responsibility to the Under Secretary of Defense for Personnel and Readiness, USD(P&R), for overall supervision and policy direction on

the commissary and exchange operations. The Military Departments, through their representation on the Commissary Operating Board, advise the USD(P&R) on the funding and operation of the commissary system and assist in the overall supervision of the Defense Commissary Agency. The Military Departments have fiduciary responsibility for funding the three exchange systems and each Military Service supervises their Exchange through a board of directors. Where the commissary and exchange interests intersect, the Congress showed great foresight by establishing the Executive Resale Board.

Commissary Operating Board. The Commissary Operating Board, chaired by Lieutenant General Ann E. Dunwoody, USA, has proven most effective in making recommendations that the Military Services will support financially and supervising DeCA's performance. The Board provides critical advice on the commissary stores needed by the Military Services, management initiatives to improve DeCA's performance, and priorities for investing in systems and construction. Under the Commissary Operating Board supervision, DeCA's management has a proven track record of achieving performance goals. Since 2000, DeCA increased sales, sustained capital investment, and reduced costs through business process improvements – all while improving customer savings and satisfaction ratings.

Executive Resale Board. The Executive Resale Board, which I chair, advises the USD(P&R) on the complementary operation of commissary and exchange systems. Since its members may also serve on the Commissary Operating Board and the Exchange boards, the Executive Resale Board shows great potential to improve oversight where there are mutual or competing interests. The Executive Resale Board reviews joint construction projects, resale information system standards, resale cooperative efforts, combined store operations, and evaluates merchandise authorized for sale, including the results of the impulse merchandise test in commissaries. In this regard, the resale commanders are compiling their first year test results on the ten commissaries selling

film, one-time use cameras, and telephone cards. As requested by the Congress, the Department will furnish a report within 60 days.

The Executive Resale Board recently tasked the Resale Commanders to evaluate opportunities to operate collaboratively, such as alternative store formats and placing exchange food operations in commissaries. Since the "combined store" format, with its limitation on appropriated support, has not been successful in the U.S. as a way to continue commissary and exchange support, the Director, DeCA and Commander, AAFES are examining options to alleviate the financial losses at the two remaining combined stores, operated by AAFES at Naval Air Station, Joint Reserve Base, Fort Worth and the Homestead ARB.

THE CHALLENGE OF CHANGE

The road ahead is a challenging one for our military families and the institutions that serve them. Our commissaries and exchanges are supporting military personnel and their families as the force mobilizes, deploys, and rotates in large numbers. In addition, the military community is migrating to a new global posture and domestic base structure to which our commissaries and exchanges must adapt. Finally, our resale activities must respond to rising customer expectations and the reality of competition in a global and networked marketplace.

Commissary and exchange benefits are important contributors to readiness. There is, therefore, no choice but to adapt the commissary and exchange programs to the challenge of change while continuing to deliver the benefit. That alone would be hard, but, in an increasingly tough fiscal climate, these institutions have to adjust to BRAC and global repositioning, meet their world-class competitors head-on, embrace the internet, support a warfight, and do all of that WHILE improving performance.

Another challenge is to attract members to our retail complexes on military installations. Two-thirds of our active duty families live off-base, and this number will

grow in the years ahead, and over half of military spouses work. As the structure of the military community changes, we must continue to develop other ways to serve patrons who are not close to an active duty installation -- including our Guard, Reserve, and retired members. Where it makes sense to build and operate stores, the unprecedented increase in construction costs dictates that we create the optimal store designed for the location and population it serves. DeCA and the Exchange Services are using technology and best practices to build and operate attractive and efficient retail outlets offering goods and services that are tailored to the local military market.

These are complex challenges that require careful consideration as we manage these critical benefits. We will continue to work with the vast network of our industry and community partners who have a large stake in the viability of our programs. We remain open and committed to different ways of doing business, but we cannot sacrifice the well being of our people and readiness of the force.

The Department recognizes the unflagging determination of our commissary and exchange employees to guarantee future success. With the help of Congress, we must enable their creativity, experimentation, and imagination. The Department places great confidence in the Resale commanders and trusts their capability to navigate their organizations through the changing retail and defense environments. The Military Departments also recognize their fiduciary responsibility to provide the resources and set the direction and goals to sustain the commissary and exchange benefits for the ultimate stakeholders, the military members.

APPROPRIATED FUNDING FOR MILITARY RESALE PROGRAMS

The Department's goal is to sustain the commissary and exchange benefits, without increasing appropriated fund costs. The President's budget submission continues the Department's strong support for Service members and their families.

The Fiscal Year 2008 budget fully funds the operation of the commissary system, including foreign currency fluctuations. The DeCA operating costs are budgeted at $1,266.8 million. The appropriations request of $1, 250.3 million covers the operating budget, adjusted for prior years. The Commissary Operating Board closely monitors funding to ensure that DeCA is funded commensurate with its mission and the support provided to each Armed Service. DeCA's strong stewardship of taxpayer dollars has been demonstrated by the fifth consecutive unqualified audit opinion of its financial records.

The Fiscal Year 2008 budget requests $241 million of support for exchanges, which includes $188 million to fully support transportation requirements to ship U.S. procured goods to overseas locations, as is required by the law. The Fiscal Year 2008 budget requests $90 million for exchange programs that support security stabilization efforts in Iraq and Afghanistan and the fight against terrorism in other locations.

MEASURING COMMISSARY AND EXCHANGE PROGRAM EFFECTIVENESS

Commissaries and exchanges exist to deliver results. We must establish ambitious long term goals to demonstrate that our commissaries and exchanges, individually and in aggregate, are meeting the needs of our Service members and are contributing positively to recruiting, retention, and readiness. We monitor program performance through the Commissary Operating Board, the respective Exchange Boards, and within my office. The commissary and exchange performance are components of the Quality of Life Social Compact Improvement Index in the Performance Accountability Report and the Department's Annual Report to the President and the Congress. This attention continues to stimulate improvements within the programs and refinements of the measures and benchmarks.

DeCA operates under Balanced Scorecard performance metrics. In Fiscal Year 2006, DeCA met all goals. DeCA is improving the quality and availability of goods,

maintaining sales levels, reducing costs, and pursuing efficiencies through business system modernization and re-engineering stores and headquarters. These improvements translate to superior customer satisfaction and 32 percent savings for the commissary customer. The Office of Management and Budget (OMB) rated DeCA "Moderately Effective" using the FY 2007 Program Assessment Rating Tool (PART). OMB concluded that commissaries provide a valued benefit to eligible patrons, but also noted that the Department lacks independent evaluations of the commissary's specific contributions to recruiting and retention.

The exchanges are making progress toward producing more standardized performance measures against program and financial goals established by their Military Services. Each of the exchanges is improving business processes and modernizing technology to improve program delivery and operate more effectively. The audited financial statements report that the exchanges are in sound financial condition, with Standard and Poors ratings of A-1+. The exchanges are meeting the goals set by their boards for savings to the customers, sales, profits, capital expenditures and MWR dividends. The exchanges contract for a uniform measurement tool to assess customer satisfaction and are using the results to tailor their organizational initiatives to improve their performance.

The Defense Manpower Data Center periodically surveys our customers to understand how they value commissary and exchange benefits. In addition, the Department uses the American Customer Satisfaction Index (ACSI), a nationally recognized measure of customer satisfaction that includes the largest U.S. retailers, as a general measure of satisfaction with the commissary and exchange benefits. These tools, along with the commissary and exchange customer satisfaction assessments, help us identify improvement opportunities that cut across all retail activities. One such opportunity is to address customer expectations about their commissary and exchange. The Department is encouraged by the Resale systems' initiatives to invest in technologies

and expand communication channels that will give customers more information about best value and access to their resale benefits.

MIGRATING TO THE NEW GLOBAL POSTURE AND DOMESTIC STRUCTURE

Access to the benefits is a pressing concern as we bring thousands of military families home from overseas and close and realign bases. The Department recognizes our obligation to work with the affected communities. DoD is partnering with other Federal Agencies and civilian communities to augment quality of life programs at the gaining installations in the U.S. With our resource constraints, commissary and exchange stores can only be provided at locations where there is a sufficient concentration of active duty members who use our activities.

By divesting resale and MWR operations that are no longer required to support active duty missions, resources can be redirected to support the military communities that will experience a significant increase of active duty personnel. Where base populations will grow more than 25 percent in two years, the Military Services may request military construction funding. We add commissary surcharge and nonappropriated funding only when military construction funding is not available or authorized. Some facility projects slated for surcharge or nonappropriated construction may be delayed as we give priority to the needs of active duty populations at the gaining installations and ensure that quality of life programs are sustained.

For the joint installations created under BRAC, we are working with the Military Departments and the installation commanders to manage the change. The Military Exchanges may continue separate operations; but, the morale, welfare and recreation programs will merge at all but one location (Henderson Hall/Fort Myer). This is a complex undertaking due to the different ways that the Armed Services distribute

dividends, allocate funding, and operate their quality of life programs at the installation level.

As a general rule, we do not continue resale operations after an installation closes. At the installations closing under BRAC 2005 and based on our experience in previous BRAC rounds, it is unusual for Local Redevelopment Authorities to seek continuation of the resale activities. As we evaluate specific locations, our primary consideration is the impact of closure and realignment on active duty personnel and their families who use the commissary and exchange. We would continue an operation only if there is a significant active duty population remaining in the area that would otherwise not be supported.

Some overseas changes have already been implemented in Germany and the Republic of Korea within the framework of negotiations with host nations. DeCA and AAFES are realigning and rescaling each commissary and exchange to coincide with the changes. Where new missions or significant troop movement create facility requirements, appropriations and funds available under host nation agreements will be sought. At closing installations, agreements with host nations govern payment for the value of our facilities. As implementation progresses, the Resale and MWR programs may absorb some implementation costs and lose some overseas revenue, which may affect capital investment and MWR dividends.

CAPITAL INVESTMENT PROGRAMS

We appreciate the support of Congress to use appropriations to replace facilities destroyed and damaged by the 2005 hurricane season. As requested by the Subcommittee, the Department is reviewing the cost effectiveness of purchasing commercial insurance for real property. Our findings will accompany the report the Subcommittee requested on the funding and standards for MWR, commissary and exchange facilities. In view of the effects of BRAC, restationing, and rising construction costs, these reviews are timely.

DeCA forecasts sales over $5.4 billion that produce surcharge revenues of $279 million in Fiscal Year 2008, although there are fewer stores and a shift of customers from Europe to the U.S. In Fiscal Year 2008, DeCA plans nearly $250 million of capital investment, with $50 million earmarked for information technology modernization and $200 million for facilities and equipment. DeCA is reviewing facilities requirements to more closely approximate current costs and standards. The Commissary Operating Board will provide valuable counsel concerning the actions needed to maintain quality commissary facilities.

Collectively, the exchanges estimate profits of $444 million in 2007. The exchanges continue to plan for Defense-wide capital investment programs averaging in excess of $500 million each year, with $145 million identified for information technology modernization and $386 million designated for construction and equipment. On a combined basis, the exchanges plan to distribute $304.7 million (61 percent) of their 2006 profits as dividends, down from $312.5 million in FY 2005. Dividends are projected to fall to $261 million in Fiscal Year 2007. The Department's report to Congress on facilities funding and standards will address each Exchange individually, since the Military Services separately manage their capitalization programs.

THE FUTURE OF THE EXCHANGE SYSTEMS

Force repositioning, BRAC, and the Global War on Terror, will continue to challenge exchange profitability. Rather than adopting the Unified Exchange Task Force recommendations, Dr. David Chu, the USD (P&R), agreed with the recommendation by the Military Departments that the individual exchange boards assume responsibility for deciding the way ahead, since each of the boards has a fiduciary responsibility to their stakeholders and is obliged to act in the best interest of those stakeholders.

Each Military Department tasked their Exchange board of directors to build on the Task Force work by seeking views on the future of the retail industry and developing

business proposals for joint support that could complement transition to the new defense environment. All three of the exchange systems are modernizing their practices to remain competitive in a challenging retail market. The Exchange boards are pursuing cooperative efforts to maximize efficiencies in systems, logistics, and supply. The Exchange Commanders are following a disciplined project management approach to identify projects, goals and benchmarks. I will ensure that we create strong performance goals and effective oversight mechanisms and have every confidence that our exchange programs will successfully transform to the new defense environment.

CONCLUSION

Mr. Chairman, commissaries and exchanges are an essential component of our quality of life programs. We must institute necessary changes so our men and women in uniform today continue to view these services as one of their most valuable non-pay benefits. The military resale system has the management, resources and drive necessary to see these important benefits through the challenges of transformation and changing expectations.

RECORD VERSION

STATEMENT BY:

MAJOR GENERAL PAUL W. ESSEX, USAF

COMMANDER, ARMY AND AIR FORCE EXCHANGE SERVICE

BEFORE THE

MILITARY PERSONNEL SUBCOMMITTEE

OF THE

COMMITTEE ON ARMED SERVICES

UNITED STATES HOUSE OF REPRESENTATIVES

110TH CONGRESS, 1ST Session

HEARINGS ON

MORALE WELFARE AND RECREATION PROGRAMS

AND RESALE ACTIVITIES

13 MARCH 2007

NOT FOR PUBLICATION
UNTIL RELEASED BY
THE HOUSE ARMED
SERVICES COMMITTEE

Mr. Chairman and Members of the Subcommittee. As Commander of the Army and Air Force Exchange Service (AAFES), it is my privilege to once again appear before this Subcommittee to share this command's strategic direction, business plans and some future challenges. On behalf of the military community we serve, I want to thank this Subcommittee for your support of the exchange benefit and our quality of life programs.

AAFES has a long and proud history of service and support to America's armed forces, and 2006 was no exception. We continue to fulfill our historic two-fold mission; to provide quality merchandise and services at competitively low prices to Soldiers and Airmen stationed around the world; and to generate reasonable earnings to augment the Army and Air Force Morale, Welfare, and Recreation (MWR) programs. This foundation of service and support is at the center of all we do at AAFES. We take great pride in being the retailer of choice for service members and their families at home and abroad and in our contribution to military quality of life, readiness, and retention.

For nearly 112 years, AAFES' goal has been to support the men and women of the armed forces around the world in peace and in war. "We go where you go" epitomizes the AAFES mission, particularly when our service members are stationed far from American soil. AAFES currently delivers the exchange benefit to deployed troops through more than 50 base/post exchange (BX/PX) facilities, 184 name brand fast food operations, 69 phone centers and hundreds of concession activities throughout Iraq, Afghanistan, Kuwait, the Horn of Africa, Bosnia and Kosovo. This commitment of resources makes it clear that support to deployed forces is one of the most important jobs AAFES will ever do.

Operations of this scope, in locations that are often austere, would be impossible without the dedicated and enthusiastic AAFES workforce. On any given day, about 450 devoted AAFES

volunteers are deployed in support of Operations Enduring Freedom (OEF) and Iraqi Freedom (OIF) and since 9/11, nearly 2,000 associates have left the comforts of their home and family—often choosing to extend their tour or redeploy a second or third time. When 450 associates are deployed, their home stores are stretched thin. Jobs go unfilled and junior employees work hard as they step in for more experienced associates.

Total AAFES operational support for military contingencies and natural disasters increased significantly in 2006. AAFES associates took the exchange benefit to the Bright Star exercise in Egypt, to firefighters battling wildfires in Washington State, to the National Guard Border Patrol Operation in New Mexico, and to four locations in Central and South America where the Southern Command is building new roads and infrastructure.

Not only does AAFES provide support to deployed personnel directly, we also offer programs that allow family members and other US citizens to show their patriotic spirit. AAFES has prepaid calling cards for sale at www.aafes.com to anyone wishing to donate to "Help Our Troops Call Home." Since the inception of the program in 2004, more than 192,000 cards have been purchased to help service members stay in touch with family and friends. There is also a link on the website for purchasing gift certificates for deployed troops that can be redeemed in any military exchange in the world. Americans have generously contributed in excess of $1.7 million for these "Gifts from the Homefront." AAFES also provides the Patriot Family Connection which allows the American public to send troops messages of support that are seen and heard in exchanges throughout the contingency theater and overseas.

No matter where military members serve, AAFES provides a comprehensive and customer–focused benefit. In addition to our flagship main retail stores, AAFES operates convenience stores, car care centers, military clothing sales stores, fast food restaurants, retail concession services like flower shops and gift stores, vending, telecommunications services and

a wide variety of personal services through more than 3,100 facilities in 31 countries, five US territories, and 49 states. Overseas, AAFES operates bakeries and dairy, ice cream, and water plants to ensure our shoppers have access to the same quality products they enjoy in the United States. We bake and package goods not only for sale in exchanges, but also for issue to commissaries, dining facilities, hospitals, and clubs. In support of Department of Defense (DoD) schools overseas, we are providing more than 24,000 lunches every school day at 99 schools in nine countries.

AAFES also offers a wide variety of merchandise through our e-commerce and catalog platforms, which we operate on behalf of all exchanges. The exchange has been in the mail-order business since 1904 and we publish two "big book" catalogs and numerous supplemental catalogs each year. Online shopping has become as common as traditional store browsing. To keep our services convenient to the customer, AAFES provides the exchange online store via the aafes.com website. Troops and their families know they will find the low prices and great values they have come to expect from their exchange shopping experience, regardless of whether they visit an exchange location, order from catalogs, or shop online at www.aafes.com.

To remain responsive to the needs of those we serve, the exchange services must continue to provide the product selection in the categories of merchandise that military shoppers expect. AAFES will continue to advocate for the repeal of the merchandise restrictions that deny Army and Air Force families the ability to buy a more extensive range of products and services from their exchange. This will please our customers and allow the exchanges to increase support to the MWR programs.

Satisfying our customers is a top priority and one for which AAFES received several national awards in 2006. Nation's Restaurant News honored our food operations, which stretch from Ft Bragg to Baghdad, with the 2006 Golden Chain Award, while DiversityInc named

AAFES a Noteworthy Company for demonstrating corporate diversity success. Furthermore, AAFES was ranked 38th on the National Retail Federation's Top 100 Retailers list and rated 60th in the Guide to Retail Web Sites top 400 Internet Retailers.

As you can see, AAFES is more than just a retail store. As one of the largest employers of military spouses and family members, it is also a part of the fabric of military life. Currently, about 23 percent of AAFES' more than 45,000 associates are military family members and another 1.1 percent are military members who work part time in the exchanges during their off-duty hours.

In 2006, AAFES embarked upon one of its most challenging years in recent history. Unmet retail industry expectations, the impact of troop restationing, and long-term support of contingency operations are some of the challenges AAFES faced in 2006. Remarkably, we project revenues for AAFES fiscal year (FY) 2006 will reach $8.9 billion, an increase of $257 million over FY05. Earnings subject to dividend are expected to be $330 million. This represents a one percent increase from FY05 and is six percent higher than the financial plan for FY06. The ability to surpass the plan is attributed in large part to Congress' supplemental funding for our support of the military missions in the War on Terror; AAFES was reimbursed $80 million in FY06. This funding helps offset extraordinary expenses incurred during operations in OEF/OIF. Without this support, MWR dividend contributions would have been significantly reduced. For FY06, AAFES is expected to contribute $219 million in dividends which support the Army, Air Force, Marine, and Navy service members.

AAFES receives minimal indirect appropriated funds (APF) to support exchange operations. The largest component, $136 million, was applied to Second Destination Transportation (SDT) expenses in 2006. Second Destination Transportation funding enables AAFES to provide balanced pricing for Soldiers and Airmen stationed overseas and fulfills

Congressional intent to provide the staples of an American lifestyle and improve the quality of life for military families serving abroad. AAFES takes very seriously its role as steward of these appropriated funds and implemented a number of initiatives that avoided $18.6 million in SDT costs in 2006.

AAFES earnings not only generate dividends directly supporting MWR programs, but also provide for re-investment in capital infrastructure for new and renovated facilities without expense to the taxpayer. AAFES invested $195 million in capital improvements in 2006 to build and upgrade 275 new activities that serve as retail, dining, and services destinations for military families around the globe. Currently, more than $473 million of improvement projects are under construction at installations such as Ft Benning, GA; Ft Campbell, KY; Schofield Barracks, HI; Beale AFB, CA; Andersen AB, Guam; Ft Lee, VA and Peterson AFB, CO.

AAFES continues to exhibit solid financial performance, but to properly plan for the future we must clearly assess the strategic situation. AAFES contends with the pressures of an extremely intense, aggressive, and competitive retail environment. Military transformation, including the impacts from BRAC and GDPR, competition for installation support funds and the support to long-term contingency operations create challenges that require strategic thinking, organizational agility, and the flexibility to implement better ways to conduct business. For those reasons, AAFES is focused on two strategic imperatives: first, to be the best retailer we can be; and second, to develop and grow new, profitable businesses.

To be the best retailer, supply chain transformation is critical to improving performance. We are implementing a new web-based transportation management system that will improve visibility and control over the entire supply chain network. Another key component of our capital investment strategy has been Project Retek, which is scheduled to begin full implementation by the first quarter 2008. This initiative is the largest information technology project in AAFES

history and will help AAFES increase sales, reduce inventory investment, increase gross profit and decrease operating costs. We expect to generate savings of $537 million over five years and project a $261.4 million positive impact to earnings. To support the transformation into the Oracle Retail software, AAFES is reorganizing its Sales Directorate and has established a Business Intelligence Group to improve corporate level, long-term analysis and research that will help us better deliver the right product, at the right price, and at the right time.

The second strategic imperative, to develop and grow new, profitable businesses, will allow AAFES to help installation commanders provide better quality of life and community support for their troops while reducing reliance on APF. We will continue to work with all the DoD stakeholders and with private sector partners to improve military communities.

Since my previous testimony, we have created a Strategic Partnership directorate within AAFES to concentrate on identifying and developing new, profitable business opportunities. Presently, this team is focusing on several initiatives, including Community Development and Advanced Telecommunications.

In recent years, the retail landscape has increasingly shifted away from traditional formats to emerging "lifestyle centers"; retail developments reminiscent of the small downtown shopping districts and town centers where parents strolled along with their children on their way to the local ice cream shop or to the park to feed the birds. That sense of place and spirit of community is becoming a central part of commercial retail developments once again. Conventional covered malls anchored by department stores, such as the nearby Springfield Mall, provide some sense of place, but their enormity provides little convenience. Power centers – a "big-box" super center surrounded by strip shop retail - offer high convenience, but no sense of place.

Because military consumers desire a sense of community and convenience that lifestyle centers can provide, the AAFES Community Development Initiative is aimed at creating a safe and secure environment where service members and their families can shop, watch a movie or get a bite to eat, all within a close distance of their homes. With the installation planners and all of the relevant DoD stakeholders, we are focusing on building communities where shoppers feel an emotional attachment and a sense of place – key factors that positively impact military recruitment and retention. Integral to the success of these new developments, AAFES is creating partnerships with the Army Family and MWR Command, Air Force Services, as well as DeCA to broaden the offerings and leverage the natural synergies that exist between these organizations.

Not every installation is geographically or physically suited to the new town center concept. In these cases, AAFES is implementing a new shopping center prototype that will afford military shoppers maximum convenience and choice. These one-stop facilities focus on low prices, large assortments, and expanded name brand fast food and services. The first prototype shopping centers are now open at Holloman AFB, NM, Los Angeles AFB, CA, and Stuttgart Panzer Barracks; Grafenwoehr, Germany will open this year. The success of this strategy is already apparent by the 30 percent increase in sales at these larger facilities.

Another format that has become increasing popular in recent years is the supercenter concept, which combines grocery items with general retail merchandise. We recognize that any proposals for implementing this concept on a military installation would require consideration of the unique and fundamental differences between the missions and funding streams of the commissary and the exchange; DeCA supported by APF and AAFES fueled by Soldier and Airmen dollars.

In the last few years, we have all witnessed a significant change in the telecommunications industry and its effect on how we obtain Internet, cable television, and telephone services in our homes. Previously, we obtained such services from three separate companies. Today, many of us obtain all three services from a single company. At the same time, changes in technology allow us to provide that convenience to our Soldiers and Airmen overseas and stateside. Our new Advanced Technology Initiative will allow AAFES to explore partnerships with leading companies in the telecommunications industry to provide service members and their families the same entertainment experience on overseas bases as they could have in the United States. We believe this initiative will dramatically improve quality of life for our Soldiers and Airmen throughout their military career and help grow the MWR dividend.

In addition to the internal AAFES efforts to improve operational efficiency, profitability and growth, we are engaged in cooperative effort initiatives as a means to implement synergistic efficiencies among the various elements of the military resale system. For many years, the Military Exchange Services have participated in cooperative efforts, collaborating on projects of common value. In 2006, the Exchange Cooperative Efforts Board placed additional emphasis on these initiatives. Three core cross functional teams are focusing on short- and long-term efficiencies across the exchanges: indirect/non-resale procurement, logistics and enterprise architecture. A fourth team is addressing cross acceptance of exchange gift cards which will become a reality later this year. Initial discussions with our Army MWR and Air Force Services colleagues have also generated ideas that could support common warehousing, transportation and food service procurement. We have made great progress in strengthening these relationships and in defining common objectives.

Discussions on mutually beneficial cooperation are not limited to our sister NAF organizations. AAFES recently began exploring initiatives with DeCA that focus on win-win-

win opportunities for both organizations based on three guiding principles: maintaining or growing the MWR dividend, reducing DeCA's APF requirements, and growing their surcharge account. I say win-win-win because these combined efforts should result in benefits for the exchange, DeCA, and the military community. We are exploring ways to collaborate, but we must be careful not to subsidize APF responsibilities with NAF resources. This is especially important in the intense budget pressures of a wartime environment when mission requirements soak up every excess dollar and the funding obligations for quality of life programs are largely unmet.

In summary, while AAFES continues to meet the unique and diverse needs of mobile military service members, the road ahead is a difficult and challenging one. The actions we take together today will ensure the long-term fiscal viability of AAFES tomorrow—with a focused and dedicated effort on our mission of serving the best customers in the world.

I look forward to your questions.

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HOUSE ARMED
SERVICES COMMITTEE

STATEMENT OF

RADM ROBERT E. COWLEY III

BEFORE THE

HOUSE ARMED SERVICES COMMITTEE

SUBCOMMITTEE

ON

MILITARY PERSONNEL

13 MARCH 2007

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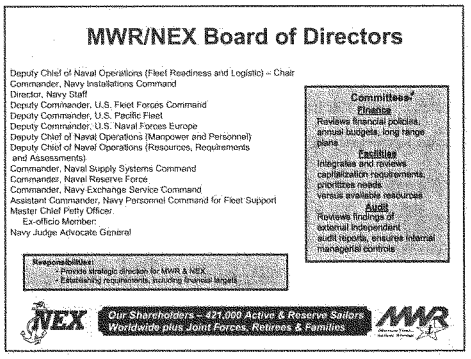
SERVICES COMMITTEE

Mr. Chairman and Distinguished Members of the Subcommittee, it is my great privilege to represent the Navy Exchange System (NES) and our dedicated associates worldwide, and it is my honor to update you on our Quality of Life (QoL) Program serving Sailors, their families, reservists, retirees, and joint forces worldwide, everyday. During April 2006, we proudly celebrated our 60th Anniversary providing the Exchange Benefit to the Navy Family since 1946, contributing more than $2.2 billion over the period to Navy Morale, Welfare and Recreation (MWR) Programs. While our operations have greatly changed since then, our commitment to the Military Family has remained steadfast and strong.

QoL Programs are critical to attracting and retaining a high quality Naval and Military Force. These programs demonstrate Navy's commitment to Sailors and their families, recognizing their dedication and sacrifice to our nation. QoL Programs are not just the right thing to do, but research has shown that such programs positively and directly affect the recruitment, retention, and performance of our people. Our Sailors can better concentrate on accomplishing their missions, when they know they and their families are being well cared for. Navy Exchange (NEX) plays a critical role in family readiness. This role was best described by Admiral Mike Mullen, Chief of Naval Operations, who said, "I am convinced that family readiness is tied directly to combat readiness. Our families serve as we serve..." Today, I will report on what NEX is doing to fulfill this critical role today and in the future.

It begins with our QoL mission, which we deliver through our global retail and service operations – *"Providing quality goods and services at a savings and supporting Navy MWR Programs"*. Balancing this mission is the role of Navy's combined MWR/NEX Board of Directors. As QoL Programs contribute to personnel readiness and effective functioning of the Navy, our Board of Directors (BoD) is comprised of Senior Navy leadership assigned broad responsibilities for Navy QoL Programs, as well as Fleet customers.



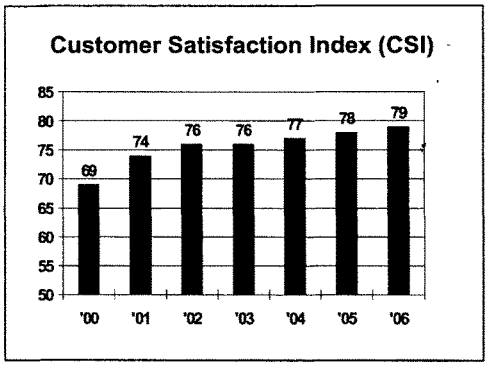
This Board sets the strategic direction and provides specific guidance, as required, for MWR and NEX to ensure both programs align to meet the needs of our forces worldwide through effective programming and adequate appropriated and non-appropriated fund support. Following BoD direction and guidance, everything we do is focused on Sailors and their families.

We serve Sailors and their families at base installations and regions worldwide, where our General Managers report to Installation Commanding Officers and our District Managers report to Regional Commanders; all part of Navy's Community Support

alignment. Our sales and advertising flyers feature command and customer testimonials from Commanding Officers to young enlisted members on why they value NEX. We also work with MWR programs, providing cross-promotional support of the many programs they offer. Last year, CNO launched the Navy Professional Reading Program, "Accelerate your Mind", designed to contribute to Sailors' professional and personal growth, education and development and to stimulate critical thinking. NEX was selected as the enabler of this important Navy program, making the books available aboard fleet units, in libraries, and in global NEX locations, as well as on-line and through our retail sales call center. Too, NEX is a participant in CNO's Wellness Study Group to identify how we can better provide Sailors with healthier food options in support of Navy's "Fit for Life" Program. In addition, NEX continues to play an important supporting role in Navy's disaster relief mission. We continue to work with other Navy elements on crisis response plans to address large-scale disaster such as hurricanes, typhoons, and influenza pandemics. All of these initiatives leverage our mission of service to our military members. Our entire enterprise, Merchandising, Store Operations, Food Service Operations, and all our support functions, are aligned for Navy and Navy Family support; building upon our vision of "One Team, One Focus, One Mission".

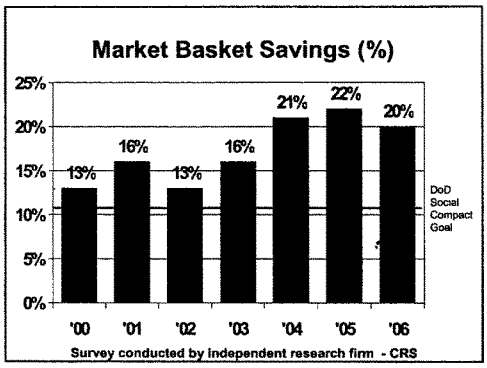
While our mission is QoL, we deliver the Exchange Benefit through our global retail operations and services. We measure our program execution using standard commercial retail methods and metrics, using third party commercial retail intelligence firms serving the commercial retail industry at large. We know that key to keeping our service members happy and satisfied is to provide them the opportunity to tell us what they want

and then deliver it to them at the best value. Toward that end, we survey our customers annually to develop a Customer Satisfaction Index (CSI) using Claus Fornel International, Group. During 2006 we received an index score of 79, one point over the prior year and more importantly continuing a seven year consistently improving CSI trend. This trend, with this year's index score of 79, places us in the very top quartile of participating commercial retailers.



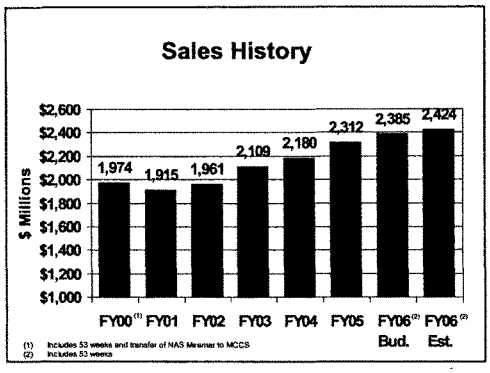
From this CSI survey, we know that savings is the key driver for customers shopping at NEX. Seventy-four percent of NEX patrons cite savings as the major reason for using NEX. This is a significant change from one year ago, when forty-six percent cited savings as the major reason. This illustrates the impact of economic pressures and higher fuel prices on Navy Families. This survey also tells us that delivering value, not just in retail operations, but also through the broad services portfolio we offer, is very important to our families. As in the commercial sector, convenience is important to our service members and families and NEX is addressing this critical need. Where we can, we offer our products and services portfolio at one convenient location – one stop shopping.

Our mission is to provide savings. These savings multiply our service members' purchasing power – a non-pay benefit. To measure our effectiveness, we conduct "Market Basket Surveys" twice yearly using RetailData, Inc. On average, we provide twenty percent overall savings, exclusive of sales tax, measuring our eight major markets.

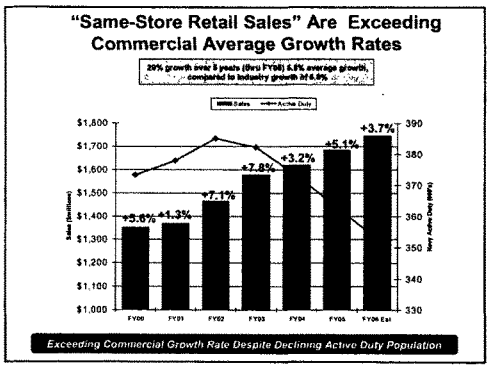


Including sales tax raises overall average savings to twenty-six percent. This market basket analysis surveys approximately 450 branded items in our eight major markets – Norfolk, VA; Jacksonville and Pensacola, FL; Bethesda, MD; San Diego, CA; Pearl Harbor, HI; Seattle, WA; and Great Lakes, IL – against a portfolio of 200 commercial retail firms.

Also, like our commercial retail counterparts, we measure our financial performance by sales and profit execution-to-plan. Our total sales execution has been on a continuing upward trend since FY01, meeting or exceeding our BoD approved annual financial plan targets.

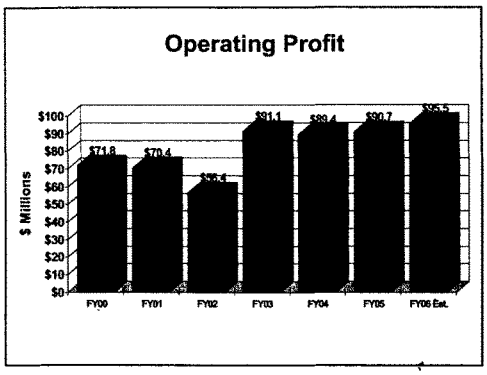


Same-store, or comparable-store, sales percentage increase is another key metric in the commercial retail industry, measuring real retail sales growth for stores open a full year; thereby normalizing the impact of newly opened or closed stores during the period. Despite a declining active duty population, we have achieved twenty-nine percent growth over the past five years, averaging 5.8 percent annually which exceeds the average commercial retail growth of 5.6 percent. These "comp-store" sales numbers are another measure demonstrating we continue to address the needs of our service members.



NEX is also a source of revenue for Navy MWR operations. Our continuing dividends provide stable cash flows to maintain our Navy MWR programs, assisting in

supporting recreational facilities and services required by our Sailors. Our profit execution has been consistent, meeting BoD identified MWR requirements.



Our relationship with and support of MWR goes much further than dividends. We are truly partners in delivering Navy QoL, working together to complement our operations and seeking cross-organizational efficiencies in the delivery of our programs.

A significant difference between NEX and commercial retailers is the broad diversity of our store portfolio. The top third of our stores account for just under ninety percent of our total exchange operating profit. Thirty-six percent of our stores generate less than $5 million in sales annually and are considered "Fact of Life" operations. Despite this, these smaller stores are just as important to Sailors' QoL as are larger ones; in many cases more so, because they are in remote or overseas locations. NEX supports locations with an active duty presence to meet Navy's requirement for comparable level of QoL support to each member and their families no matter where they are assigned around the world. By meeting this requirement, we are an organization of smaller stores.

As Navy's operations evolve around the globe, so too will NEX operations. Last year, we opened a new NEX Store in the Kingdom of Bahrain. What was previously a Ship Store with several hundred line items is now an NEX offering some 20,000 line items. From the day the doors opened on the new facility, the response from our Fifth Fleet Sailors has been overwhelming. We will continue to work to better support our forward-deployed troops to ensure their needs are met in all locations.

We currently employ sixteen different store models within the NES. We utilize large retail stores, small retail stores, convenience stores, gas stations, uniform shops, hospital stores and student stores for the greatest efficiency and effectiveness in support and retail operations. No store is the same size, same configuration, or offers the same merchandise assortment; and all are customized to meet the service needs of the disparate base installations, regions, and customer groups we serve. And, we are comprised not only of retail operations, but also multiple commercial services, food service operations, personal and vending services. We do this through 1,364 different store front operations.

Our operations cross the spectrum of commercial retail store categories. These categories include discount mass retailers, department and specialty stores, convenience stores, and specialized discount stores. Exchanges are the only single retailers that sell hardlines, softlines, electronics and consumables, at opening, moderate and higher price points. The brands we sell cover each of our customer segments using multiple brands comprised of the various price points. Eighty-plus percent of our sales in both dollars

and units are in opening and moderate price points. We provide best value and quality to all our patrons, no matter what their income level.

Addressing the needs of our active duty, reservists, retirees, joint forces, and family members is the driving focus of our program. The needs of our single Sailors are different from those with families. The needs of our reservists, retirees and joint forces differ also. Commercial retail models show that to be a successful "going concern" you must focus on the needs of your target market. Given our mission and our diverse customer base, we cannot serve just one group; we must meet the needs of all. I am pleased to report that Navy Exchange continues to refine our merchandise assortment that has proven successful in meeting the needs of all in the past. We continue to rationalize our assortment through customized customer segmentation. Through information obtained from our CSI analyses, we have identified eight distinct segments covering the life cycle of our service members from newly enlisted Sailors to 65 and over retirees. We are able to break out the percentage of each of these segments by store to enable us to better customize our merchandise assortment to meet their individual needs. We are excited to be able to bring this industry best practice into our operations, giving us another way to further customize our stores to meet our diverse customer base.

At sea, we take care of our Sailors through our very robust Ships Store Program. In any given day, fifty-two percent of Navy ships are at sea and thirty percent are forward deployed. We provide health and comfort, convenience, and entertainment merchandise – everything from toiletries to electronic entertainment media, snacks, reading material

and high-velocity uniform items. All items are sold at a savings while generating profits to support afloat MWR Programs. We also provide vending and non-retail services, including barber shops and laundry operations. In a single day, an aircraft carrier will process 2,400 pounds of laundry, provide 168 haircuts and sell 9,000 sodas. Our Sailors rate Ships Store as one of their Top Five QoL programs.

Our commercial Telecommunications Program keeps Sailors in touch with their families and friends no matter where duty calls. The majority of the services provided are through contracts with our commercial business partners, who also provide the required infrastructure and maintenance. Our Afloat Program provides ship to shore personal calling via satellite on 183 Navy ships and Coast Guard vessels at only 45 cents per minute, a fifty-five percent reduction in the calling rate since the inception of the program in 1997. We also provide free phone cards to Sailors, Marines, and Coast Guard personnel who are deployed at sea during holiday periods. In 2006, we provided 17,000 such free cards. Our phone cards offer low calling rates within the United States and around the world with savings up to thirty-eight percent on calling within the U.S. and up to forty-seven percent on calls to the US. During times of crisis, such as Hurricane Katrina, the Pacific Tsunami, and the evacuation of Beirut, Lebanon, we also provided free phone cards. Further, we provided cards to Naval Hospital Bethesda for the wounded service members returning from Iraq. Cellular services are provided through our industry partner who waives activation fees for the military members and their families. Likewise, termination fees are waived for deployments and permanent change of station transfers. Staying connected through access to the internet is important to our

Sailors and we have collaborated with MWR to supply "no cost" wireless service to MWR Single Sailor Centers, libraries, and NEX food courts.

Our Navy Lodge Program was established to support Sailors and their families on permanent change of station orders. This mission has evolved to serving all active duty personnel on orders or during leisure activities. As with our retail operations, we measure our Lodge Program execution using standard commercial hospitality methods and metrics, using third party hospitality intelligence firms as available. Navy Lodges continue to win the prestigious Meritorious and Golden Pineapple awards from the American Hotel and Lodging Association. Navy Lodge current occupancy rate is eighty percent compared to an industry average of fifty-six percent. The Navy Lodge Program continues their assistance with the Wounded Warrior Program in support of wounded service members returning from Operation Iraqi Freedom/Operation Enduring Freedom. Navy Lodges provided over 13,500 room nights in 2006 for lodging to family members of injured service members, and to the service members themselves. I commend all our Navy Lodge associates for the excellent support they provide our wounded service members and their families in a very difficult time.

During last year I had the opportunity to revisit our Navy Exchanges in the Gulf Coast. What a difference a year makes. When I first visited in the aftermath of Hurricane Katrina, the devastation was enormous. I am pleased to report that our extensive recovery efforts have been completed and Navy Exchanges have returned to normal business operations. I am proud of how far our facilities have come and thank our associates and our industry partners who made it all possible.

As you can see, our passion is caring for our Sailors in many ways. I will now report on selected initiatives we have undertaken to ensure the viability of the Exchange Benefit well into the future and our continuing effort to improve the service we provide to our patrons. We are currently engaged in several program-level modernization initiatives – logistics/supply chain management, non-resale procurement consolidation, and enterprise architecture modernization. Our Logistics/Supply Chain Management Program brings together merchandising, distribution, marketing, operations, financial management and information systems departments within NEX headquarters and field environments, as well as our industry partners, to rationalize and improve the entire supply chain from the shelf back to the vendor. We are aggressively attacking lead times and understanding where opportunities exist to shrink "pipeline inventory" along the entire supply chain. All participants are focused on getting the right merchandise to the sales floor in the quickest and most cost-wise method possible, driving greater operational efficiency and effectiveness.

As I have reported in past testimony, we continue to update our enterprise business architecture and enabling technology to increase customer savings and reduce operating cost. I am pleased to report that our Enterprise Information System Program, Oracle Retail, is deployed across our NEX enterprise and is operational. Oracle Retail is a state of the art commercial system that employs a merchandise system, store inventory management system, warehouse management system and data warehouse, and provides forecasting and optimization tools. In addition to our Oracle Retail Program, we have deployed three other enterprise systems, Lawson Purchase Order for non-resale

procurement, Computer Associates Asset Management System for fixed assets, and MEI Easitrax for world-wide vending management. We are now focusing on our broader Enterprise Business Architecture, a methodology to drive change and standardization. This program will document operational, systems and technical views of NEX's business architecture at the process level, a set of technology standards, and a governance model to drive change and modernization across NEX business operations.

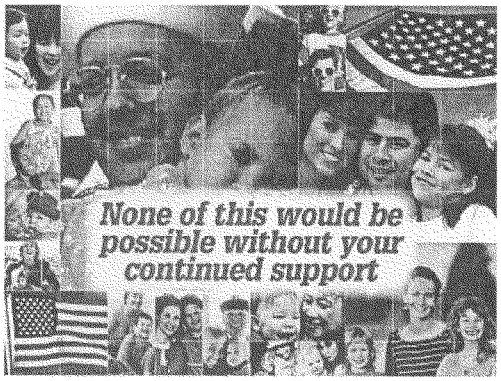
Exchange Commanders and Director DeCA have developed an excellent collective working relationship. Using the combined creative talent of the three Exchanges and DeCA, we are leveraging our joint efforts to make our organizations collectively stronger to meet future challenges. Exchange Services have a mutual respect for the valuable role each play in meeting their respective Services' missions. Through the Exchange Cooperative Efforts Board (ECEB), our teams will continue to find back room efficiencies supporting the Exchange operating companies – Army and Air Force Exchange Service, Marine Corps Community Services, and Navy Exchange System – addressing our respective qualify of life missions for Airmen, Marines, Sailors, and Soldiers.

Our commercial industry partners are valued and vital members of our team. They share our mission and dedication to our military members and their families. During 2006, with their support, NEX was able to bring many special events and celebrities to locations all around the globe. Sailors on the USS Kearsarge were treated to an onboard premier showing of "X-MEN III - The Last Stand". Stars from the movie (Halle Berry,

Hugh Jackman, and Kelsey Grammer) were flown aboard ship to meet the crew and sign autographs. Other celebrity appearances included Pamela Andersen, Chef Emeril Lagassi, New York running back Tiki Barber, author Tom Clancy, and the Washington Redskin Cheerleaders, to name a few. None of this would have been possible without the great support of our industry partners. Also through the generosity of our vendors, Customer Appreciation Days have been held at Guantanamo Bay, Guam and Naples. These special events provide our forward deployed customers a super sale opportunity coupled with entertainment and exciting activities. Customers come to the store at opening and often stay the entire day enjoying the sales, food, and fun. In partnership with our industry partners, it is a special way to connect with our customers and thank them for their service to our country. Another way industry touches Sailors is by recognizing the top Sailors in the Navy each year with their donations to the Sailor of the Year program. The support of industry doesn't stop there. We also work side by side with them as we strive for more efficient operations, particularly our Supply Chain initiatives. We value their expertise and advice, and deeply appreciate all they do for our military members.

Mr. Chairman and Distinguished Members of the Subcommittee, we have come to rely on the absolutely superb support of this Subcommittee in taking care of our military families. Through your sustaining efforts, we are able to do more for our Sailors and their families. On their behalf, I thank you. In closing, please know Navy Exchange continues to be a "going concern", financially strong, and engaged on many fronts to improve the QoL of Navy families. Together with our commercial and government

partners, and with the strong support of this Subcommittee, the Exchange Benefit will not only be sustained in the future but improved, remaining a critical non-pay benefit for Sailors and their families who serve our country with such great dedication, energy, and pride.



STATEMENT OF

PATRICK B. NIXON

DIRECTOR, DEFENSE COMMISSARY AGENCY

BEFORE THE

MILITARY PERSONNEL SUBCOMMITTEE

OF THE

COMMITTEE ON ARMED SERVICES

UNITED STATED HOUSE OF REPRESENTATIVES

FIRST SESSION, 110th CONGRESS

March 13, 2007

NOT FOR PUBLICATION UNTIL RELEASED BY THE HOUSE ARMED SERVICES COMMITTEE

Mr. Chairman and Members of the subcommittee, it is my pleasure to appear before you this year in my new capacity as the Defense Commissary Agency's (DeCA) director to provide an update for the Agency's performance this past year. Once again DeCA reached new highs in sales growth and customer service. The cost of providing the commissary benefit when measured in constant fiscal year 2000 dollars continues to decrease. We have picked up the pieces in the Gulf Coast area and the level of operations in that region is recovering. The reorganization and centralization of Agency support functions and the re-engineered processes completed this year have truly increased the value of the benefit without increasing its cost. The 18,000 employees who operate the commissary system and do such a great job running our 263 stores worldwide continue to be a source of personal pride as they rise again and again to deliver astonishing business results in the face of significant resource challenges. Combined with a dedicated management team, the administration and operation of the commissary benefit has never been stronger. Of course, for the employees at DeCA this really isn't a job, but rather a task of love, and the personal satisfaction garnered by observing the results of our daily efforts on the faces of those who go in harms way and those of their families provides immense satisfaction that keeps the commissary at the heart of the Quality of Life benefit for the men and women who proudly serve our great Nation! After all, we serve the most deserving customers in the world and with all they've been through we owe it to them to provide the best possible benefit, the highest savings possible, and the overall best shopping experience we can, providing the items they want in modern accessible facilities. In short, they should enjoy a similar experience to that they would find in the retail supermarket located outside the gate.

Our performance continued to excel for fiscal year 2006 ushering in another impressive year. Once again the numbers say it all — sales were up, costs were down, customer satisfaction

measurements increased and customer savings remained constant. While we believed our sales would level off in 2006, or even decline with the lost sales opportunities in the Gulf Coast, they actually increased, with annual sales totaling $5.42 billion. While not a primary goal, increased sales are an important measure of merit for DeCA because they are a visible demonstration of the value of the commissary benefit to our patrons. At the same time our costs again came in under program. When measured in constant Fiscal Year 2000 dollars, the administration of the commissary benefit today continues to remain below what it cost in 2000; and if we went back to the year DeCA was activated and used constant 1992 dollars, the commissary benefit delivered today costs just a little more than half of what it did then. Again, the reduction in constant dollar cost has been gained—not at the expense of our customers—but because of the efficiencies we developed and deployed throughout the Agency. This was confirmed by our overall customer service satisfaction score of 4.61, on a scale of 5—another rise this year which demonstrates the patrons believe we are obviously doing it right. Again this year our internal measures were validated externally by the American Customer Satisfaction Index (ACSI). While DeCA's FY 2006 score remained the same at 77, it continues to be higher than the commercial supermarket national average of 75. The primary change this year is that the commissary ranked second behind a single supermarket chain in customer satisfaction among the U.S. largest private sector supermarket chains.

Of course, customer savings continues to be the heart of the commissary benefit. It is the level of savings that we provide to the military community and the fact that we deliver commissary items at the same price to all locations including remote locations and overseas environments that make the commissary benefit one of the highest valued benefits provided our military personnel. Based on U.S. Department of Agriculture grocery cost data and commissary

savings of 32 percent compared to shopping at commercial supermarkets, we estimate that a family of four that purchased all its groceries in DoD commissaries and ate all its meals at home, could save about $3,000 a year. We could not achieve this level of savings for our military families without the tremendous support our trading partners provide in pricing and promotion of their products. I would like to take this opportunity to again publicly acknowledge and thank them for their support of the commissary benefit.

DeCA has also demonstrated the governance attributes of a successful governmental entity. In 2006, DeCA was evaluated using the Program Assessment Rating Tool or PART. The PART is the Office of Management and Budget's (OMB) "... systematic method of assessing the performance of program activities across the Federal government. The PART is a diagnostic tool; the main objective of the PART review is to improve program performance. The PART assessments help link performance to budget decisions and provide a basis for making recommendations to improve results. The PART is composed of a series of questions designed to provide a consistent approach to rating programs across the Federal government, relying on objective data to assess programs across a range of issues related to performance." Assessed factors that affect and reflect program performance include program purpose and design; performance measurement and evaluations; strategic planning and program management; and program result. OMB evaluated DeCA as "Moderately Effective". According to the OMB ranking standards, "Moderately Effective" programs are well-managed and have set ambitious goals.

Many other factors also demonstrate that DeCA possesses the governance attributes of a model governmental entity. Of significance is DeCA's Internal Control program. As you know, the Revised OMB Circular A-123, Appendix A requires agencies to report on the effectiveness

of their Internal Controls over financial reporting. Effective Internal Controls over financial reporting are an important element in the submission of annual statements of assurance. Not only was DeCA's FY 2006 Annual Statement of Assurance Scorecard rated the highest in DoD, but the Department's Comptroller consistently holds DeCA up as the model for other DoD activities to emulate in implementing their Internal Control programs. Because we review all our major processes, our strong Internal Control effort contributed significantly to DeCA receiving its fifth consecutive clean audit opinion on its financial records. That audit reviews all of our money accounts—sales, surcharge, capital investment and the annually appropriated operating funds; and daily activities such as how accurately we record time and attendance and maintain physical inventory and accountability of assets at our activities worldwide.

On the BRAC front, after the dust has settled only six installations with a commissary store are scheduled to close. On the other hand the Overseas Integrated Global Presence Basing Strategy is expected to impact 28 commissaries. Of more concern than the scheduled closures are those sixteen installations where DeCA operates commissaries both overseas (six) and in the United States (ten), that are projected to gain significant personnel as restationing progresses. We will need to program for new construction or expansion of existing facilities to accommodate the increased personnel at the gaining installations. This situation has required that we reprioritize our construction programs and reevaluate our store replacement model to accommodate these additional requirements.

Of course, BRAC and overseas restationing are not the only demands on the surcharge program. The worldwide increase in construction costs, and the tremendous information technology investments required to replace cash registers, have created significant challenges. Needless to say, however, without your foresight in passing the Surcharge Revitalization Plan in

2000, we would be in much worse shape today and would only have had enough surcharge to perform required repair and maintenance on our stores. Our BRAC related reorganization plans are well under way. We have completed realigning many of the functions performed in the regions, centralizing their control and performance under the appropriate headquarters staff element. We have closed the former region offices in Virginia Beach and San Antonio. Those closures were required as a result of BRAC 2005, and the region functions previously performed in those locations have been co-located with our Headquarters at Fort Lee. The addition to the Headquarters building required to accommodate the remaining off installation functions currently performed in leased space in Hopewell, Virginia, has been funded by BRAC and its design is under way. We expect construction to start later this year. We do not anticipate transferring our Human Resources Operations Division, currently located in Arlington, to the Defense Logistics Agency until the 2008-2009 timeframe when DeCA converts to the National Security Personnel System. The combined personnel functions will be performed in Columbus, Ohio.

As I mentioned last year we have been focusing our reengineering efforts to optimize our business processes using Lean Six Sigma. We have completed 17 Lean Six Sigma projects that have increased operational efficiency while reducing cost. Two examples of our more successful projects are the consolidation of our Information Technology Help Desks and the reengineering of our equipment inventory management procedures. Both projects resulted not only in a reduction in cost, but also an increased efficiency.

A number of the programs, some of which I mentioned last year, continue to provide value to our patrons.

Of course, first and foremost on everyone's mind today is food safety. The E. coli outbreaks and spinach scares of last year have made food safety the "industry's top priority". To provide an additional level of food security which I believe commissary patrons deserve, late last year I directed that DeCA would observe the source inspection requirements of the United States Army's Veterinary Command for the acquisition of food and water. We will only use suppliers for commissary products that undergo a source inspection from those listed in the Worldwide Directory or from those sources inspected by other federal entities recognized by the DoD Approved Sources Division. Current and potential suppliers of commissary products requiring a source inspection have been made aware of this guidance to ensure they understand and obtain the appropriate inspections before they begin, or within a reasonable time of beginning, to supply DeCA; when changing manufacturing or processing plant locations; when selecting subcontractors; or when expanding their contract to introduce additional products into the commissary system that require source inspection. We are working closely with the Army's Veterinary Command and the United States Air Force Public Health Service to ensure military families receive this extra layer of food security for those products that have the most risk of harm to their health.

The DeCA/TRICARE partnership for the "It's Your Choice, Make It Healthy" program, highlighting healthy foods available in military commissaries, has been extremely successful in informing military families about eating healthier and promoting concepts such as weight management and fitness, not only physical but also financial, as they save by shopping their commissary. While many of our larger commissaries have already been configured with "Wellness Centers" to highlight products for health conscious patrons, we will soon deploy the showplace "Wellness Center" in our flagship store at San Diego, scheduled to open next month.

Combined with an increased selection of natural and organic foods, and the addition of a dietitian to the DeCA staff, the "It's Your Choice, Make It Healthy" message is reaching military families around the world. Having a registered dietitian on staff increases DeCA's ability to educate customers on how to make healthier meal choices at the commissary – reading product labels, enjoying more fresh fruit and vegetables and leaner meats, and preparing meals at home instead of hitting the fast food drive thru or spending hard-earned money at restaurants. Some of the initiatives planned for the DeCA dietitian include an "Ask the Dietitian" feature on the DeCA Web site and increased visibility for the recently revamped "5 A Day for Better Health" program, which focuses on fruits and vegetables. We were also pleased to honor the request of an independent commercial grocer near Boston to utilize our "It's Your Choice, Make It Healthy" materials so they could provide their "...retired military customers and associates, who find it difficult at times to get to the closest commissary ...[this] essential nutritional information for healthy food choices."

In keeping with its nutritional leader goals, DeCA commissaries joined this year's Family Day – A Day to Eat Dinner with Your Children. A national event, established by Presidential Proclamation, the program is intended to remind Americans of the importance of staying involved in their children's lives. Over 10,000 military families signed the Family Day pledge by accessing the National Center on Addiction and Substance Abuse web site at Columbia University, through a link from DeCA's web page. To draw even greater attention to Family Day, the military sales team of the Coca-Cola Company sponsored a three-day, two-night trip to New York for one military family. The winner will also get a family dinner cooked by Sandra Lee, best-selling author and host of the Food Network show "Semi-Homemade with Sandra Lee." Partnering with DoD schools, TRICARE and family organizations such as the National

Military Family Association, Family Day was a ready fit with DeCA's "It's Your Choice, Make it Healthy" initiative encouraging military families to think of the commissary as the place for healthy food, healthy savings, and healthy family.

Our Internet venture—the Virtual Commissary, which currently features gift packs of items, at commissary negotiated prices, will soon be expanded and a variety of individual commissary items will become available to commissary patrons whose eligibility is verified through the Defense Enrollment Eligibility Reporting System (DEERS) database. We anticipate having a contractor who will pick, pack and ship individual products ordered by authorized patrons from a selection of commissary items, again at commissary prices plus a fee for shipping, handling and delivery to their location, on board this summer. We are excited about this initiative which, while available to all authorized patrons, is primarily designed to take the commissary to those Guard, Reserve and retiree families who do not live near a commissary and to those deployed to forward areas.

The change instituted last year in our produce procurement methodology that adopts the best practices of the supermarket industry, has shown results beyond anyone's imagination. Wherever the change has taken place, tonnage sold is up, patron savings have increased, and customer satisfaction is simply phenomenal. Shoppers are buying more produce, because they get higher quality at lower prices than before. In fact, for the second year we have continued to see double digit increases in produce sales. But beyond just increases in produce sales, we have seen patrons return to the commissary more often to do their fill in shopping as a direct result of this newly implemented program. It is this type of initiative that enables us to increase the value of the commissary benefit without increasing its cost. And behind the scenes, ordering and receiving is more efficient. As a result, the stores' produce personnel have more time to spend

setting and maintaining the displays and generally being out on the sales floor serving our patrons. It is a tremendously successful program. Thank you for your insight in supporting the adoption of commercial produce industry practices.

While we had hoped to have our produce program fully implemented, as you know the government contracting process allows multiple opportunities for bid protests, and that process has to run its course. While we used produce industry inputs to develop our program; maintained it as a 100% set-aside for small business participation; and competitively awarded the contracts, we received several bid protests that slowed the process slightly. At this time most of the legal issues for the contracts have been resolved, with the Government Accountability Office sustaining our actions in every instance on the protests they have decided. We anticipate the two remaining challenges will be favorably resolved shortly and that soon all of our patrons will be able to enjoy the savings and quality provided by this program throughout the commissary system.

Of course, other programs available through the commissary have helped military families as well. Since the Gift of Groceries program began in the fall of 2002, over $11 million in commissary gift certificates have been provided to military families. Since its inception in 2001, the Scholarships for Military Children Program has provided more than $5 million to nearly 3,000 students, and we expect another 500 students will each receive a $1,500 scholarship this spring. Contributions by industry companies that support the commissary system, as well as from members of the general public, totally fund this program. They deserve our heartfelt thanks for their assistance in making life just a little bit easier for military families.

Other advancements are making the commissary more effective, efficient and customer friendly. Our new front end system, the Commissary Advanced Resale Transaction System

(CARTS), is being deployed now. CARTS features new cashier stations designed to dramatically improve how stores process customer transactions. This new generation of front-end technology provides a simple to use, accurate and secure scanning system for purchases. In addition to the "full lane" that allows customers to process large orders, it includes several types of self-checkout modules. Whether one is looking for the "express" feature when purchasing fewer than 15 items; or a moderate order of 30 items, there is a self-checkout option that lets the customer do it his way. Other features that improve the shopping experience include a 15-inch color screen display so customers can better view their purchases, hand-held scanners for cashiers to reach bulkier items in the cart, and self-help price check stations located for customers around the store.

Our Workforce of the Future is developing a store workforce that is simple in design, easy to manage, cost effective and more productive while maximizing the changes anticipated by implementation of the National Security Personnel System. It is being deployed to 51 stores this year, and we plan to complete deployment to the remaining stores within the United States by December 31, 2008. As you may recall our workforce model, based upon that used in the commercial grocery industry, eliminates12 different position descriptions, replacing them with two — a multi-skilled Store Associate and a General Manager. When deployed, this model will position the government workforce to be more competitive in future A-76 studies.

Beyond the commissary benefit I believe that working together with my Exchange brethren, we can strengthen the entire military resale system without adversely impacting any of the individual components. Starting with the merchandising test you chartered, the Exchange Commanders and I have opened discussions in a number of areas. I believe there are a number of opportunities which will provide a win for the exchanges, a win for the commissary, but above

all a win for the military resale patron. Some examples of areas we are exploring are sale of exchange merchandise in commissaries and a shared facility concept. Providing an additional outlet for exchange merchandise and sharing the revenue as you authorized last year will capitalize on incremental sales which can increase contributions to MWR dividends and generate surcharge funding. Likewise, reducing the burden on commissaries and exchanges by sharing the support cost, such as personnel, front-end, and IT, by operating a commissary and an exchange under the same roof would intuitively seem to be an ideal cost reduction mechanism. These concepts are in their infancy and have much work to be done.

Next month when customers enter the new Naval Base San Diego Commissary, they will be walking into the largest, most modern military commissary in the world. The 118,000-square-foot store, scheduled to open April 20, will serve the area's 122,000 service members and their families. We call it the "store of the future" because it will have some concepts in it that we will unveil for the first time. One of them is the "store within a store" concept. A "store within a store" gives customers a choice of two primary entrances, one for the shopper who wants to pick up a few key items in as little time as possible, and one for the "pantry loader." At either entrance, customers can place deli and bakery orders at a touch-screen kiosk. The order is processed while the customer shops and can be picked up just before heading to one of 18 full-service registers or 11 self-checkouts. The store also contains a large health and wellness center that emphasizes our nutritional awareness theme. The store's health and wellness center will feature an array of organic food products. The store will also include ethnic products in the bakery, a gourmet olive bar and multiple information kiosks with interactive touch screens and print capability. The kiosks will be strategically placed like beacons throughout the store. Last,

but certainly not least, there will be a "cooking school" near the health and wellness center that will be the store hub for healthy cooking demonstrations.

Of course, our primary focus always remains on the patron and we continue to use every available avenue to reach out and inform them of the value of their commissary benefit. This continues to be a joint effort with industry member participation in providing promotional programs, such as the special high value coupon booklets made available to Guard and Reserve families that are some distance from a commissary, and the generous support of NEXCOM and AAFES in including commissary messages in their mailings to their customers. We continue to provide the value of the commissary benefit message at the Service's basic training installations. Commissaries actively participate in all pre-deployment briefs and at family support briefings aimed at Guard and Reserve families. We are continuing to partner with manufacturers and distributors to offer truckload sales of authorized commissary products at Guard and Reserve Centers, like the Hill Air Force Base commissary's helping the Utah Air National Guard in Salt Lake City celebrate its 60th anniversary. Initially this sale was going to involve just a few pallets of paper products and picnic supplies, but as other suppliers learned of the event, they wanted to support the troops and their families, too. Others have smaller programs, such as the Fort Huachuca Commissary: For two months this last summer, every Thursday afternoon at 4 p.m., they set up a roadside stand with snack and other items in the parking lot at the San Jose Lodge for Marine Reservists helping agents at the U.S. Border Patrol's Naco Station construct roads and fences. These Reservists had no direct access to the post, so we provided them an opportunity to purchase goods at commissary prices.

But perhaps the most effective outreach we have comes from the one-on-one interaction between our employees and our customers. I get many comments from those with health

problems who appreciate the assistance our employees give them with their shopping, or the support provided military units in ensuring they have adequate supplies for various organizational activities. But, I would like to share just two of the many comments I receive from those customers who tell me about their experience while shopping in the commissary that they believe go above and beyond the call of duty.

From Adrian Cook, military spouse, Tyndall Air Force Base, Florida: "[M]y groceries were checked out by Wannetta Hayes. Upon completion of the transaction, my bank card would not go through because the bank network was down. By then I was an outraged person. The bank representative did not know when service would resume. I explained this to Wannetta and told her I would be back before I went to work. Wannetta offered to pay for my groceries. That is the nicest thing anyone has ever done for me. She knew I was upset and embarrassed, and she made all of that go away. Wannetta paid for a complete stranger's groceries without hesitation. She is one in a million."

From Nora Beck, military spouse, Royal Air Force Croughton, England: "I feel compelled to write and inform you of the outstanding customer care received from Michael Suppa. My husband went shopping for some banana bread mix. He returned home without it. I assumed he forgot. When I left the house the next day, the bread mix was on my doorstep. I assumed my husband dropped the two packets. When I next went to the commissary, Michael asked me if I had received the bread mix. It turned out my husband had asked Michael for the bread mix, and they could not find any. After my husband left the commissary, Michael found the bread mix had been moved to a display by the bananas. He proceeded to purchase two packets and placed them outside my house. I live about 11 miles from the base. After speaking

to Michael, I offered money for the mix, and he refused, saying he should have been able to find the mix and not send my husband away empty-handed."

These stories sum up DeCA's commitment to the Service members and their families and demonstrates how engrained the commissary benefit has become in their daily lives. When all is said and done, it all comes down to people taking care of people – and no one does that better than those who serve the Military Services!

We, at DeCA, are proud of the contribution we make in operating the 263 commissaries worldwide that provide tremendous savings on groceries for military personnel, retirees and their families. We recognize that commissaries deliver a highly valued component of military compensation in areas where the cost of living is high, and they bring a morale-building "taste of home" feeling by providing familiar American food products in overseas locations where such products are often unavailable. A core military family support element, and a valued element of military pay and benefits, commissaries contribute to total family readiness and enhance the quality of life for America's military and their families. But, we don't do it alone, many others help us, and to recognize that this year we developed the "Champion of the Benefit" Award. I am extremely please that its first recipient is a member of this subcommittee. While this Subcommittee has championed the commissary benefit, Representative Thelma Drake has not only been a strong advocate for our military personnel and their families, but has also made it a priority to strengthen the commissary benefit and was an especially strong supporter. She recognized the value of the produce test, advocating its earliest adoption and understood the business case for consolidating support functions at the headquarters. Thank you again Mrs. Drake for your support and my thanks to all of you on this subcommittee for the continued emphasis you place on the value of the commissary benefit.

Once again it has been my pleasure to have the opportunity to tell you about the great things DeCA has accomplished this past year and of its contribution to the quality of life of our military families. I will be happy to answer any questions you may have.

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THE HOUSE ARMED
SERVICES COMMITTEE

STATEMENT OF
MICHAEL P. DOWNS
DIRECTOR

PERSONAL AND FAMILY READINESS DIVISION
MANPOWER AND RESERVE AFFAIRS DEPARTMENT
HEADQUARTERS, UNITED STATES MARINE CORPS

BEFORE THE
MILITARY PERSONNEL SUBCOMMITTEE
OF THE
HOUSE ARMED SERVICES COMMITTEE

On

13 MARCH 2007

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Michael P. Downs
Director, Personal and Family Readiness Division

Michael P. Downs entered the U. S. Marine Corps via the Naval Reserve Officers Training Course, and was commissioned a second lieutenant in June 1961. In April 1962, he completed The Basic School in Quantico, VA, and was assigned to a transplacement battalion where he served as a platoon commander, company commander, and assistant operations officer at Camp Pendleton, CA, and the Far East until December 1964. His next assignment took him to Marine Barracks, Yorktown, VA, where he served until February 1967. He was promoted to first lieutenant in December 1962, and captain in September 1965.

Upon completing the Amphibious Warfare School in Quantico in September 1967, he was transferred to the Republic of Vietnam where he served with the 1st Marine Division as Commanding Officer for Company F, 2nd Battalion, 5th Marines; Assistant Operations Officer for the 5th Marine Regiment; and Operations Officer for the 3d Battalion, 5th Marines. While serving as Company Commander of F/2/5, he was awarded the Silver Star Medal for heroic actions during Operation Hue City in February 1968.

He returned to the United States in October 1968, and was sent to Quantico where he was assigned to the Development Center, and to The Basic School, and then to Marine Barracks, Washington, D.C. He was promoted to major in November 1968. After his tour in the National Capital Area, he attended the U.S. Army Command and General Staff College, Fort Leavenworth, KS, and upon graduation in July 1975 was assigned to Okinawa, Japan, where he served as Executive Officer, 1st Battalion, 9th Marines, 3d Marine Division.

Follow on assignments included Headquarters Marine Corps, Washington, D.C., where he was Administrative Assistant to the Deputy Chief of Staff, Operations and Training , and then monitor for Ground Lieutenant Colonels; student at the National War College, Washington, D.C.; Plans Officer at Headquarters, Allied Forces Central Europe, Brunssum, The Netherlands; Director of Operations and Training , and Commanding Officer, 27th Marines, 7th Marine Amphibious Brigade, Marine Corps Air Ground Combat Center, Twentynine Palms, CA; and Deputy for Marine Corps Matters, Office of Program Appraisal, Department of the Navy, Washington, D.C. He was promoted to lieutenant colonel in November 1977 and to colonel in November 1982, and was selected for promotion to brigadier general in December 1986.

In March 1987, he was assigned as the Director, Facilities and Services Division, Headquarters Marine Corps, where he remained for more than two years. In July 1989, he was transferred to Camp Lejeune, NC, where he served first as Commanding General, 6th Marine Expeditionary Brigade, and then as Commanding General, Marine Corps Base. He retired from the Marine Corps in August 1992 after more than 31 years on active duty.

After his retirement from the Marine Corps, he was a consultant to the U.S. House of

Representatives, House Appropriations Committee, and to Textron Inc. He became Director, Personal and Family Readiness Division, Manpower and Reserve Affairs Department, Headquarters Marine Corps, on May 1, 2000.

He is married to the former Martha Leigh Puller, of Saluda, VA. They have two sons, Mike Jr., and Burwell.

Chairman Snyder, Congressman McHugh, distinguished Members of the Military Personnel Subcommittee, thank you for this opportunity to testify before you today. Although the Subcommittee plans to hold separate hearings on military resale and Morale, Welfare, and Recreation (MWR) programs this year, this statement reflects the posture of the Marine Corps Community Services (MCCS) Program which encompasses both the Marine Corps Exchange and MWR Programs.

The expansive, combined arms reach of MCCS touches almost every corner and square foot of an installation and includes over 80 programs supported by a common overhead and management team. Established in 1999, the MCCS of today is nearing 10 years of service to Marines and their families. As with Marines who first earn the Eagle, Globe and Anchor upon completing the Crucible and Boot Camp, the integration of the Marine Corps Exchange, MWR, Family Services, Child Care and Voluntary Education Programs is also a transformation. Establishing MCCS required the concerted effort of everyone involved with strong leaders at every level, to guide or force this change in direction, and a firm belief that the change was right for the Marine Corps. Today, just like your Marines, MCCS is a strong, well-supported component of the Marine Corps that is recognized for critical recruiting, retention, and readiness support because of its value to individual Marines and their families.

With our earned success and belief in transformation, MCCS shall be continuously poised and ready to listen, learn, and respond to the needs of Marines, their families, and the Marine Corps institution. In this regard, the Commandant of the Marine Corps has established Marines in

combat and Sailors serving with us as our number one priority. Over the past year, your Marines deployed to all corners of the globe in support of our Nation's combat or humanitarian missions. With more than 20,000 Marines ashore throughout the U.S. Central Command's Area of Responsibility, Operations Iraqi Freedom and Enduring Freedom (OIF/OEF) remain our largest commitment. In addition to those operations, the Marine Corps also deployed forces to: support humanitarian and disaster relief efforts; participate in over 50 Theater Security Cooperation events; protect our Embassies; and respond to a Non-Combatant Evacuation from Lebanon, the largest since Vietnam. For the future, the Marine Corps is committed to the defense of our homeland and to remain faithful to our mission—to be where our country needs us, when she needs us, and to prevail.

Marines and the families of Marines, who sacrifice so much for our Nation's defense, should not be asked to sacrifice quality of life. MCCS has been and will continue to be a forceful advocate for Marine Corps quality of life requirements. Over the next few years, we will aggressively seek ways and means to sustain and even improve the quality of life of our Marines and their families. In the process, we will remain critically attuned to assessing the effectiveness of our organization, programs, and services. Marines are not hesitant to learn from Sister Services and use the best practices of commercial industries. MCCS is additionally committed to providing our Commanders with the necessary tools, templates, policies, and resources so that they may proudly fulfill the Marine Corps enduring commitment to every Marine and their family that Marines take care of their

own. We believe that we have all necessary resources to address any identified deficiencies, but, will not be reluctant to ask Congress for help as may be required.

Marine Corps Exchange Operations

The Marine Corps Exchange (MCX) has been proudly serving Marines and their families since 1897. Times changed, business practices evolved, and customer services continued day-to-day. Over five years ago, however, we started really listening and learning more about our customers and realized that every facet of the MCX shopping experience needed to be specifically touched and modernized. Today, amid the dust, construction, change orders and boxes, we must remind ourselves and our customers that the pain of transformation is temporary but the pride of the Marine Corps Exchange is forever. This pride will only grow stronger with completed renovation of our Exchanges at MCAS Miramar, MCB Quantico, and MCAS Cherry Point, projected for this fall.

At the same time we directed change to our outward face to the customer, we have modernized our internal functioning as well. New levels of operational excellence began with centralized buying but continue with and are enabled by leveraged logistics and implementation of our new information technology systems. As a result, we are better, smarter, and more efficient resale managers and service providers. We are additionally proud that the previously forecasted savings are being realized from this enhancement of our back office functions.

Looking to the future, we have developed a long-term strategy that accentuates our strengths. Size matters in retail and our size enables us to be agile, expeditionary,

and react quickly to new ideas. We are deliberately "branding" our experience closely to the ethos of Marine Corps pride. Our vision for the MCX in the next five years is for it to be our customers' first choice. We are viewing changes and improvements "through our customers' eyes and expectations." Our staff of retail professionals are prepared to lead us into an exciting future and beyond the pain of renovation.

New Small Store Format. At our Elmore MCX at Camp Allen in Norfolk, Virginia, we have tested our small store, shared facility prototype that combines a Marine Mart and Main Exchange. The store's new floor plan, like all our renovated and new stores, is set for a more customer-friendly shopping experience - less cluttered with ample space to shop. The store is well lit and departments are clearly identified by mounted wall signs. Aisles are set at five feet for ease in shopping cart maneuverability. The Elmore MCX design was, in fact, nominated to compete in the 2006 Design Build Institute of American National Capital Chapter Awards and won the category for "Best Project under $5 million." We have with great pride received customer feedback such as: "great place to shop" and "I love everything about this store." If increased sales signify success, sales are up at the Elmore MCX by about 61 percent and profits have increased approximately 163 percent.

Associate/Customer Satisfaction. Associates and customers alike continue to show strong satisfaction with the MCX. In September 2006, Marine Corps Exchanges, Marine Corps-wide, participated in an Associate and Customer Satisfaction Index (ASI/CSI) survey that is used to measure satisfaction levels at regular intervals, identify problem

areas, and provide recommendations for program improvement. The MCX associates' satisfaction increased over the past year by one point, to 67, continuing an increased trend over the past five years. MCX customers rated their overall satisfaction score at 71, which is consistent with the last survey. We found that pricing remains an MCX strength and is a key driver of satisfaction. Finally, the American Customer Satisfaction Index survey of the MCX increased by a statistically significant three points in 2006, from 67 to 70. We know more work must be done, but are confident we will continue forward progress.

Price Survey. In cooperation with the Navy Exchange Command (NEXCOM), and the Army Air Force Exchange System (AAFES), the MCX participates in a yearly price survey to measure customer savings. The most recent survey was conducted from October 8 - 15, 2006 in 10 market locations. A product list consisting of 373 line items representing 36 merchandise categories was used to accumulate pricing data across the specified market locations. Survey findings revealed an MCX savings range from four percent on low margin merchandise, such as health and beauty and lawn and garden items, to a high of 60 percent on high margin merchandise, such as luggage and cameras. In aggregate, the MCX offers customers an average market basket savings of 16 percent before taxes. To increase potential awareness of savings from shopping the MCX and connection of the revenue generated to dividends for MWR facilities, programs, and services, we are planning several initiatives designed to alert customers.

New Business Ventures. MCX continues to enter into new business ventures with popular brands that Marines and their families prefer. For example, in Fiscal Year 2006,

sales of Brooks Brothers apparel were over $1 million; sales of Vera Bradley handbags and accessories were at $661 thousand; and we sold more than $351 thousand worth of Dell computers. We will continue to provide preferred name brands to our customers.

Armed Services Exchange Merchandise Restrictions (ASER). Enhancing the shopping experience and ensuring customer satisfaction, includes not only offering our patrons the brands they want, but also the best possible merchandise selections. We continue to maintain, however, that ASER restrictions no longer have a useful purpose, but rather force Servicemembers and their families to shop outside the gate, exposing them to higher prices and unfavorable credit terms. We look forward to working with the Congress to lift the remaining restrictions on diamonds and furniture at the earliest possible date.

Exchange Cooperative Efforts Board. As stated previously, Marines are not hesitant to leverage the best practices of Sister Services or commercial industries for the benefit of the Marine Corps. As we end 2006 and begin 2007, we believe a spirit of increased trust and openness exists among our sister Exchanges and the Department of Defense about the future and protection of the military exchange benefit that will be further developed through the Exchange Cooperative Efforts Board (ECEB). The ECEB specifically has tightened administrative procedures and established a formal process management system that will enable joint analysis of key cooperative initiatives that have the greatest potential for return on investment and/or improved operational efficiency of the military Exchanges in the areas of enterprise architecture, logistics, indirect procurement, and gift cards. We will continue to

jointly work on efforts that make sense for our patrons and provide value.

Nonappropriated (NAF) Fund Construction. Over the next five years, the focus of the NAF construction program will be placed on renovation/replacement of our Exchanges. By improving the shopping experience, we hope to attract more customers and increase sales. For Fiscal Year 2006 through Fiscal Year 2009, the MCCS Board of Directors has approved 11 Exchange renovation, expansion, or replacement projects at a cost of $91.4 million.

MCX Sales and Profits. This year, the MCX had an unprecedented year in earnings, which demonstrates that we are better adapting more to the ebbs and flows of deployments. Additionally, our payroll is declining due to the efficiency of centralized buying and centralized accounts payable and our product assortment and selection continues to improve.

In Fiscal Year 2006, Exchange sales were $764 million, an increase of one percent over the prior year. It is important to note that approximately $100 million in sales were realized by AAFES for Marine-operated forward exchanges in Iraq and that these sales are not included in MCX sales results. Our MCX profits for Fiscal Year 2006 were $47 million, an increase of 65 percent over last year. Although a portion of this increase is a result of corrected overhead allocation between the MCX and MWR program, the importance of this increase in profitability is that we are now realizing the benefits of the MCX centralized buying, centralized accounts payable, and branding efforts. Margins improved while payroll costs decreased. These profits resulted in a significant

increase in dividends to $33.4 million.

Morale, Welfare, and Recreation

MWR programs must be adaptive and evolve to meet the needs of those they serve. Marines and their families have key demographic differences when compared with Sister Services. For instance, the Marines are younger, more junior, and less married than the other Services. Additionally, Marine families, on average, are also considerably younger. We must be responsive to all demographic segments and mitigate the challenges and inherent risks of our force. We have found great success and help in evolving our programs with the use of Functionality Assessments (FA)s, which I will mention throughout this portion of my statement. To date, 14 FAs have been conducted encompassing more than half of our programs.

Deployment Support. Over the past four years, we have learned that we must be focused on providing support throughout the entire deployment cycle with programs and activities designed to address specific pre, during, and post-deployment issues and challenges. For Marines deployed to OIF/OEF, the focus is on providing refreshed services and support that help mitigate the risks of isolation and separation for a force that has endured many combat deployment cycles. On the home front, this new emphasis has resulted in the reinforcement of the roles and responsibilities of unit Commanders and highlighted the importance of educating Marines and their families about the realities of deployments and the programs available to mitigate negative behaviors.

In addition to deployment-specific MWR support, MCCS provides many of the spaces, places, and programs that promote social interaction, encourage active lifestyles, and maintain "livable communities" where our Marines and their families make their homes.

Fitness. Marines are warrior athletes and need a comprehensive fitness program to develop and sustain the physical skills necessary for combat, including core strength, endurance, speed and coordination. We offer numerous programs to help them attain healthy lifestyles and achieve their fitness goals. I am pleased to report that the overall state of our fitness program remains strong with MCCS fitness facilities at a 96 percent compliance rate with DoD fitness facility standards. Physical fitness, however, is about more than weight rooms and running tracks. In November 2006, the Marine Corps Combat Development Command announced a new approach to physical training that will focus on preparing Marines for the tough physical challenges they will face in combat and in peacetime training. This new concept, called "Functional Fitness," will result in a major change in the way Marines view exercise and how units build training programs to prepare their warriors for combat. Aerobic training is over-emphasized in current orders and doctrine and little attention is given to strength training, general physical preparedness, injury-proofing Marines, or on training around an injury during an active recovery. Semper Fit Program Managers are working with the concept proponent to determine how Commanders can best incorporate our MCCS well-equipped fitness facilities and qualified professionals into meaningful functional fitness regimens for Marines.

To remain current and accessible to our Marines, Semper Fit has been working with the Marine Corps Institute (MCI) and the National Strength and Conditioning Association to develop three non-resident courses. The Semper Fit Basic Fitness Course provides Marines and Marine leaders with a science-based curriculum on Fitness and Exercise Science Principles, Nutrition, Injury Prevention, and Exercise Programming. This science-based curriculum provides key fundamentals to understanding functional fitness. This course has been very popular with Marines. In the time it has been available, approximately 6,700 Marines have enrolled in the course, and about 2,000 of the 6,700 have completed the course. A Semper Fit Advanced Course is under development to include topics such as Biomechanics, Advanced Nutrition, Advanced Exercise Physiology, and Supplements. The final course, Stress Management, is nearing completion. These MCI courses will ensure quality fitness education is available to help Marines meet their fitness goals. They will also provide training credits for Marines that may benefit them at promotion time.

In partnership with the Training and Education Command's College of Continuing Education, Marines are now able to complete their annual classroom Semper Fit training requirements on Fitness, Nutrition, Injury Prevention, Tobacco Cessation, Sexual Health and Responsibility, Suicide Awareness, Alcohol and Substance Abuse Prevention, and Hypertension and High Cholesterol online using a new interactive approach. So far, Marines have had great things to say about the versatility and interactive nature of the courses. From a Commander and program manager perspective, the new system allows us to track the number

and ranks of Marines taking the courses and their completion of them as well as target education programs provided based on demographics and prevalence of health risks.

Community Recreation. MCCS also offers a wide variety of recreation programs and outdoor activities that provide Marines and their families opportunities for physical activities and a balance between work and life conflicts. These activities help build a sense of community by providing inexpensive, wholesome activities that encourage social interaction and an active lifestyle. One of these important activities is the Single Marine Program (SMP). Originally created in 1995, the SMP program has provided a forum for our young, predominately single Marines to elevate quality of life concerns while offering activities that develop life skills and encourage responsible citizenship. As the program celebrated its 10 year anniversary, we undertook a review involving both single Marines and senior enlisted leadership to identify the program's strengths, weaknesses, and opportunities to grow. East and West coast conferences were conducted to consolidate, clarify, and reach consensus on the future state of the program. A few of the key recommendations included the best ways to educate Marines about the program; the need to identify a "Home of the SMP" that is centrally located to single Marines and that will serve as a hub for meetings and other activities; and to focus the program on quality of life advocacy, recreation, and community involvement. SMP coordinators are now using the feedback from the conferences to develop a plan of action that will change the program to better meet the needs of this new generation of single Marines.

Another initiative underway in our recreation community is "Are You Listening." For most of our patrons, the staffs of our recreation programs are the most visible and accessible face of all the programs MCCS offers. The "Are You Listening" initiative builds on this relationship by training our recreation staff to actively and positively interact with our patrons to identify potential risks and behavioral warning signs (such as substance abuse, loneliness and boredom, behavior/lifestyle choices, and suicidal ideations). They are also trained on resources available to Marines and families and when appropriate, how to make a referral recommendation. In August 2006, we completed a pilot training program for 17 individuals representing 13 installations. Through formal and informal surveys, participants of varying disciplines within MCCS introduced to this "Are You Listening" initiative provided extremely positive and encouraging feedback. Due to the success of the pilot training, we are in the process of formalizing a training curriculum and are scheduled to begin offering the training at Marine Corps Base Hawaii in April and at Marine Corps Base Camp Lejeune North Carolina, in May.

Children, Youth and Teens. Taking care of our youngest family members calls for a broad spectrum of programs along with a caring professional staff. In terms of DoD standards, 20 (91 percent) of our 22 Child Development Centers (CDCs) eligible for accreditation have earned such accreditation through the National Association for the Education of Young Children. The remaining two of our centers are currently involved in the re-accreditation process with completion expected by October 2007. Additionally, our School Age Care programs are pursuing

their initial accreditation from the National After School Association. Currently, 11 programs, or 54 percent, are accredited with the remaining 13 programs expected to earn their initial accreditation by the end of this year. MCCS is also exceeding the current DoD potential childcare need standard of 65 percent. At 73 percent (13,041 spaces) today, we continue to strive toward the new DoD standard of 80 percent, which is to be effective later this year. To help us meet this standard, we use the DoD-sponsored Military Child Care in Your Neighborhood Project in association with the National Association of Child Care Resource and Referral Agencies to help Marines find, choose, and pay for quality civilian childcare in their local communities. For our parents who may be working extended or irregular hours due to deployments, we expanded hours of operation at some facilities and have established Family Child Care Homes that provide extended child care in emergency situations at no cost to the parent. By spring of this year, we will also open temporary modular CDC facilities at Camp Pendleton and Camp Lejeune, that were funded last year by DoD to meet emergency needs. Camp Pendleton will open two 100-child capacity modular facilities and Camp Lejeune will open two 74-child capacity modular facilities configured for younger children.

MCCS has several information technology upgrades underway that will save our customers time and remove some of the administrative burdens of using our MWR programs. One of those upgrades which will have an enormous impact on parents who depend on our Children, Youth and Teen Programs was implementation of an automated registration and usage tracking system called the Child and Youth Management System (CYMS). Currently, CYMS is being used at six

installations to manage the day-to-day business operations of our child care programs and our remaining installations are scheduled to implement CYMS by the end of Fiscal Year 2008. The system has allowed us to put in place a more standardized and efficient program model and will provide visibility of program costs, utilization, staffing, facilities, patron demographics and medical data.

Library Programs. Libraries are more than places to check out books or to read the latest edition of your favorite magazine. They are a quiet refuge that also builds a sense of community by offering a place for multicultural activities, children's programs, teen reading clubs, poetry groups, community education, and special educational and recreational events. Among the varied services found at an MCCS General Library are a well-stocked assortment of professional and leisure reading materials; college preparation and academic research materials; multimedia materials, such as movies, books-on-tape and music; study rooms; and computer labs providing free Internet access. The General Library program is also involved in supporting deployed units, Marine Security Guard Detachments at various embassies, ships, hospitals, and air terminals by providing paperbacks, popular magazines, professional Marine Corps magazines, Professional Reading List books, and online resources.

In 2004, an initiative resulting from an FA termed "Bricks and Clicks" was developed to encompass the clickable, online aspect of library services. At the center of the initiative is a website that incorporates access to the online General Library Card Catalog, and a Google-like multimedia search engine that provides access to databases like Proquest, eLibrary, and Heritagequest,

where patrons can find the latest editions of a hometown newspaper, television and radio transcripts, audio/video files, or even research their family genealogy. To make the virtual library even more useful to patrons and program mangers, an online Needs Assessment and Library 101 Course is being developed to offer a convenient way to help patrons learn how to use the library and online resources.

Golf Programs. The Marine Corps has golf courses located in some of the best locations in the country and in Okinawa and Iwakuni, Japan. On any give day, you will find varied groups of Marines and their families on the fairways and greens of our 11 golf courses relaxing, enjoying the outdoors, and the benefits of golf gained by individual and group play. In December 2006, Golf Program Managers gathered at NAS Coronado, California, to complete an FA of our Golf Programs. This meeting was a culmination of a nine-month process that involved rigorous documentation of the current program, analysis of Sister Services and industry standards, and gathering customer feedback, with the goal of developing a plan for streamlining and improving program activities. At the end of the process, we discovered that while most of our customers were happy with our golf programs, we were not meeting industry standards in all areas. To address these issues, the program managers developed a standard staffing model and financial goals and plan to improve the bottom line by focusing on marketing the sport as a fitness activity and learning opportunity. Two key areas of emphasis will be developing golfing packages for unit events and our retiree populations and engaging our junior Marines and their families on the virtues and benefits of a family outing spent "walking the fairways."

Clubs. The Marine Corps continues to offer membership clubs for our officers and staff noncommissioned officers (SNCOs) and remains firm in our belief that clubs are a valuable place for professional mentoring and bonding. The clubs are also valuable to the Marine Corps "Institution" as a meeting place for Command-sponsored events, mission-essential training, and official representation to the public. Lifestyle changes, alcohol de-glamorization, growth in on- and off-base food offerings, and off-base living have contributed to a decline in club membership and club patronage in general. Marine Corps Leadership believes, however, membership clubs provide an important setting where the unique values and traditions of the Corps are nurtured and encouraged. This premise is the basis for a renewed effort by Marine Corps leaders and club management to seek ways to encourage officers and SNCOs to become club members and actively support their clubs.

In September 2006, a Club FA was conducted to develop a plan to improve club efficiency and effectiveness. In conjunction with the FA, nearly 8,000 officers and SNCOs responded to a club membership survey. Fifty percent of the respondents agreed that membership clubs are valuable and 56 percent reported that elimination of membership clubs would affect their quality of life. Overall, club member respondents were generally satisfied with their club. Using survey data and industry benchmarks, the FA participants established a club financial goal for each club of breakeven status within three years and developed an action plan to achieve that goal. The plan includes achieving compliance with financial standards, developing alternative sources of revenue, planning unique special events, obtaining authorized appropriated funds, and

building on our current high customer satisfaction in food and service. It also includes building club membership by expanding the standard membership card program and engaging senior leaders in club activities and encouraging the new generation of Marines to become members of their club.

We will be developing an "image campaign" to let Marines know that we've heard what they have said about clubs and are taking action to increase the value of their membership and participation. The action plan is supported by the MCCS Board of Directors and other senior Marine Corps leaders. We are optimistic that clubs will continue to play an important part in the professional and social life of Marines and be a valued community resource.

Another initiative involving our club restaurants, snack bars, and health promotion programs is a healthy eating program we have named "Fueled to Fight." This program was developed in response to requests from our health-conscious customers for more fresh and nutritious offerings at our clubs, restaurants, and snack bars. Under the initiative, 20 of our club restaurants and snack bars are now offering an enhanced salad bar and at least one healthy entrée and side dish. These menu items comply with standards suggested in the Dietary Guidelines for Americans 2005, and in many instances are existing regional or ethnic favorites that have been modified to conform to the guidelines. We have also developed "Fueled to Fight" table tents, placemats, flyers and posters that have been distributed to our fitness and recreation centers to let our customers know about the healthier menu items and to help educate customers on how to make wise choices. Good eating habits are essential to maintaining an active, healthy lifestyle and continued mission readiness.

Facilities Modernization. We appreciate the Committee's interest in ensuring nonappropriated fund construction programs adequately maintain and replace MWR facilities at an appropriate level of frequency that is commensurate with the standards of our patrons. Providing attractive, modern, and high-quality MWR facilities supports the livable community concept and encourages pride of ownership and participation in events and programs offered at those facilities. The MCCS construction program is well structured and we continue to build and renovate needed resale, as mentioned previously, and MWR facilities. In FY06, there were three MWR projects completed at a cost of $10.7 million. The projects included a Macaroni Grill at Camp Butler, Okinawa, for $5.8 million; construction of an auto skills center at MCB Quantico, Virginia, for $3.1 million; and construction of a family fun park at Kaneohe Bay, Hawaii, for $1.8 million. Planned to start construction in Fiscal Year 2007 are a renovation of the Staff NCO Club for $2.2 million and construction of a new MWR Category C temporary lodging facility (TLF) for $11.9 million for Camp for Pendleton, California; renovation of the bowling center at MCLB Albany, Georgia, for $0.4 million; replacement of the auto skills center at MCAS New River, North Carolina, for $2.3 million; construction of a youth activities center for $5.2 million and a TLF expansion for $5.2 million at Kaneohe Bay, Hawaii; and construction of a youth activities center for $6.6 million and replacement of the golf course club house, snack bar, and pro shop for $6.3M at MCAS Miramar, California.

Fiscal Year 2006 Financial Results. From Fiscal Year 2001 through Fiscal Year 2006, budgeted appropriated funding (APF) for MWR increased $87 million from $117

million in Fiscal Year 2001 to $204 million in Fiscal Year 2006. Our financials continued on target to sustain achievement of the OSD MWR 85/65 standards for Categories A and B, respectively. For Fiscal Year 2006, the Marine Corps achieved APF support of 86 percent for Category A and 69 percent for Category B. MWR funding for Mission Sustaining and Community Support programs is anticipated to remain stable through Fiscal Year 2007, with our budgeted MWR total of $213 million.

Conclusion

The MCCS is well poised for the future and will continue to provide high quality MWR and MCX programs and services. We appreciate your support of Marines and their families and efforts to protect and enhance these important quality of life benefits.

QUESTIONS AND ANSWERS SUBMITTED FOR THE RECORD

MARCH 13, 2007

QUESTIONS SUBMITTED BY DR. SNYDER

Dr. SNYDER. Cost of New Construction: The ongoing global repositioning of forces would seem to demand that some appropriated funding be provided to support construction of expanded commissaries and exchanges. Why is this realignment-based construction being financed out of accounts dedicated to routine replacement and rehabilitation of facilities? Will appropriated funds be available to reduce the pressure on the troops' non-appropriated accounts?

Secretary DOMINGUEZ. Under Department policy, appropriations may fund requirements for those installations receiving over a 25 percent increase in personnel within a two-year period. The Defense Commissary Agency (DeCA) and the Exchanges are committed to providing adequate facilities to support quality of life for the Service members and their families relocating to these installations. Although requirements were considered, sufficient resources were not available for the Department to propose funding in the Fiscal Year (FY) 2008 Budget. Therefore, DeCA and the Exchanges are reprioritizing their capital investment programs to meet the highest priority needs using commissary surcharge or non-appropriated funds in the absence of appropriated funds. Those requirements related to facility construction costs will be identified in the FY 2008 Commissary Surcharge and Non-appropriated Fund Construction Program. We continue to advocate for appropriated funding for these requirements in future appropriated budget submissions.

Dr. SNYDER. A new round of base closures was announced in 2005. In the past, there has been considerable interest in maintaining some level of commissary and exchange support at base closure sites to support the retired and reserve population. We understand that the ongoing negotiations to establish a new model for combined exchange and commissary stores has been complicated by an inability to decide which products will be sold by exchanges and which products will be sold by commissaries. Why are such decisions so difficult? Why are such decisions allowed to impede the development of a store model that is urgently needed by military patrons, particularly at base closure sites?

Secretary DOMINGUEZ. To maintain some level of support for the military community after a base closes or when separate operations are not feasible, the Congress authorized the exchanges to run combined commissary and exchange stores with reduced appropriated funding. Under the combined store concept, food items are sold at cost plus 5% and all other merchandise is sold at the exchange mark-up. Without exception, the concept has not been financially successful at base closure locations.

Under the direction of the Executive Resale Board, the Defense Commissary Agency (DeCA) and the Exchanges are evaluating other store models that may share facilities or other operating features. Because DeCA and the Exchanges are both authorized to sell certain merchandise, an important consideration is how to allocate the inventory and pricing and the residual effect on exchange profit, dividends to morale, welfare, and recreation, and commissary surcharge trust funds. As a companion effort, the Deputy Under Secretary of Defense for Military Community and Family Policy is developing a process to adjudicate such conflicts.

Dr. SNYDER. Cost of New Construction: The ongoing global repositioning of forces would seem to demand that some appropriated funding be provided to support construction of expanded commissaries and exchanges. Is the funding for new construction to support the exchange and commissary projects associated with global repositioning adequate and are those funds being provided separately or is each of you funding your own projects?

Mr. NIXON. Except for $300,000 received to offset the Base Realignment and Closure (BRAC) impact at one Air Force installation, the Defense Commissary Agency is not slated to receive any appropriated funding. Commissary requirements were considered when the Services prioritized their total requirements, but the required commissary projects fell below the cut line on the prioritized lists.

Dr. SNYDER. A new round of base closures was announced in 2005. In the past, there has been considerable interest in maintaining some level of commissary and exchange support at base closure sites to support the retired and reserve population. We understand that the ongoing negotiations to establish a new model for combined exchange and commissary stores has been complicated by an inability to decide

which products will be sold by exchanges and which products will be sold by commissaries. Has the military resale community done more work on developing new approaches for providing military resale benefits at base closure sites? What is the status of current efforts to develop a new combined store model?

Mr. NIXON. Under the direction of the Executive Resale Board, the Exchanges and the Defense Commissary Agency (DeCA) are exploring the potential as to whether a new model of combined operation might be more advantageous in providing the commissary and exchange benefits in some locations. We call this the shared facility concept, and it is still in the development stage. It envisions that a commissary and an exchange could operate in a single facility, sharing certain support costs, complying with existing statutory guidance that requires the operation of separate commissary and exchange systems. This concept has many moving parts and we have yet to resolve a number of them.

The Shared Facility concept is based upon three premises: (1) that it should enhance both exchange and commissary shopping experiences; (2) it should generate additional morale, welfare and recreation dividends; and (3) it should generate additional surcharges for DeCA, without increasing the top line appropriated costs. The Executive Resale Board is considering a process to adjudicate the merchandise authorities.

Dr. SNYDER. Cost of New Construction: The ongoing global repositioning of forces would seem to demand that some appropriated funding be provided to support construction of expanded commissaries and exchanges. Is the funding for new construction to support the exchange and commissary projects associated with global repositioning adequate and are those funds being provided separately or is each of you funding your own projects?

General ESSEX. To date, the Army and Air Force Exchange Service (AAFES) has not received any authorized appropriated funds (APFs) in support of Global Repositioning of Forces to the United States, nor has there been any indication that APFs will be forthcoming. In-turn, AAFES is required to fund capital improvements with retained earnings and accumulated depreciation for projects eligible for APF support.

The DOD authorized the use of APF's for community facility construction related to the establishment, activation, or expansion of a military installation. In the case of an installation expansion, a major increase in authorized and assigned personnel strength over a short period of time is necessary before APF construction can be programmed. A 25-percent increase in personnel over a two-year time span satisfies this requirement.

Additionally, closing installations are authorized APF support for expense items such as: civilian severance pay; permanent change of duty station; transportation costs of relocating assets; and residual value of facilities constructed with AAFES funds.

During 2006–2012, AAFES will make worldwide, non-appropriated fund (NAF) investments of more than $476M ($358M in construction costs) in new and expanded facilities. This does not include an additional $25M investment in expense items relating to installation closures.

AAFES identified CONUS facility needs totaling $359M ($263M authorized APF support) to meet quality of life requirements. Projects are being developed, or are underway at Ft. Belvoir, Ft. Benning, Ft. Bliss, Ft. Carson, Ft. Drum, Ft. Lee, Ft. Lewis, Ft. Riley, Ft. Sam Houston and Ft. Sill.

New exchange OCONUS facilities totaling $117M ($96M authorized APF support) are underway, or being developed for Andersen AFB, GU, Dal Molin, IT, Grafenwoehr GE, and Weisbaden GE.

Dr. SNYDER. A new round of base closures was announced in 2005. In the past, there has been considerable interest in maintaining some level of commissary and exchange support at base closure sites to support the retired and reserve population. We understand that the ongoing negotiations to establish a new model for combined exchange and commissary stores has been complicated by an inability to decide which products will be sold by exchanges and which products will be sold by commissaries. Has the military resale community done more work on developing new approaches for providing military resale benefits at base closure sites? What is the status of current efforts to develop a new combined store model?

General ESSEX. The Army and Air Force Exchange Service (AAFES) evaluates exchange operations at BRAC closure sites by location and adjusts the scope of operations based on a sound business case. Any operations that remain open will be monitored to ensure economic viability after closure.

AAFES and the Defense Commissary Agency (DeCA) are currently exploring the feasibility of using a shared facility concept as a potential operating model at small or downsized military installations. We are proceeding cautiously in our discussions

with DeCA to ensure we are within the bounds of Section 2481(a) of Title 10 which mandates separate exchange and commissary systems. This cooperative effort focuses on increasing the value of the military resale system for its patrons. In the shared facility concept, the commissary and the exchange remain separate entities within the meaning of the law, but reside in a single facility to maximize shared services. Commissary and exchange merchandise sales would be credited to the appropriate separate account and each organization would be responsible for its pro rata share of infrastructure costs and common operating expenses.

AAFES and DeCA will continue to address a number of major issues: defining the commissary/exchange merchandise category mix; adapting IT systems to ensure separate organizational accountability; sharing credit card fees and other common expenses; and resolving any workforce issues resulting from different human resource systems (appropriated fund v. non-appropriated fund).

Dr. SNYDER. Cost of New Construction: The ongoing global repositioning of forces would seem to demand that some appropriated funding be provided to support construction of expanded commissaries and exchanges. Is the funding for new construction to support the exchange and commissary projects associated with global repositioning adequate and are those funds being provided separately or is each of you funding your own projects?

Admiral COWLEY. In general, Navy Exchange construction required to support global repositioning at Navy installations has been minimal since the plan is still being developed. NEXCOM is working with military planners to evaluate the need to construct additional Navy exchange facilities to support a major influx of Marines to Guam from Okinawa Japan. Specific details on the scope and cost of Navy Exchange construction have not been developed pending completion of a comprehensive master plan for this initiative.

Dr. SNYDER. A new round of base closures was announced in 2005. In the past, there has been considerable interest in maintaining some level of commissary and exchange support at base closure sites to support the retired and reserve population. We understand that the ongoing negotiations to establish a new model for combined exchange and commissary stores has been complicated by an inability to decide which products will be sold by exchanges and which products will be sold by commissaries. Has the military resale community done more work on developing new approaches for providing military resale benefits at base closure sites? What is the status of current efforts to develop a new combined store model?

Admiral COWLEY. Department of Defense (DOD) policy ties the continued operation of exchanges and commissaries at closed installations to specific criteria including whether the installation has an active duty mission, the number of active duty or reserve component population remaining, and the proximity of other facilities. A combined commissary and exchange store may be considered at a closed installation upon reviewing the criteria. As the geographic area around a closed installation may have authorized patrons which would benefit from the commissary and exchange benefit, although most likely a much smaller population, determining the optimal combined store model becomes critical.

The DOD Executive Resale Board, whose members include the heads of the Defense Commissary Agency and the Military Exchange commands, is currently discussing merchandise assortments and various operating models for future combined exchange and commissary stores. The Executive Resale Board had discussions during the February 2007 meeting, and is scheduled to continue these discussions in the July 2007 meeting. No definitive future model for combined stores has been determined, however, the focus of the review is on determining the best enterprise approach to provide the commissary and exchange benefit to our military members.

Navy Exchange successfully operates a NEXMART model of combined commissary and exchange stores at nine overseas locations. This non-appropriated exchange store model delivers commissary benefits in a fully integrated facility with shared costs for common functions. The exchange labor costs associated with delivering commissary merchandise are funded by DeCA, and when normalized for operating hours this offers the most cost-wise solution compared with similar sized standalone commissaries. NEXMARTs provide added customer satisfaction with extended store hours and convenience of one-stop shopping. The commissary merchandise is procured from DeCA and sold at cost plus five percent. This combined store model works best in lower volume locations where the economies of scale with combined stores are easier to garner. These could include base closure sites.

The policy discussion about which products will be sold by exchanges and which products will be sold by commissaries becomes more pointed in a combined store. Since no gross margin dollars are produced by commissary-type merchandise sales, expenses resulting from wider assortments must be subsidized by more appropriated funding. If a combined store's goal is to reduce overall appropriations, then

it is counter-productive to subsidize these sales with more appropriated funding, especially since the same sales can be made with exchange merchandise that generates gross margin dollars to offset expenses. Thus, the practice of selling exchange-type merchandise at cost represents a significant expense for the DOD.

QUESTIONS SUBMITTED BY MR. MCHUGH

Mr. MCHUGH. The Department of Defense Instruction (DODI) 1330.21, ''Armed Services Exchange Regulations,'' issued July 14, 2005, authorizes exchanges to operate revenue generating activities such as personal telecommunications services but does not specifically address the Internet as a revenue generating vehicle. As a result, a number of organizations at the base level are providing revenue generating Internet cafes, on-line games and other Internet based activities to service members and there appears to be considerable duplication at the base level in providing such Internet based activities. It would appear that the failure of the DOD instruction to specifically address the Internet as a revenue generating activity has left a policy vacuum. When does the Department plan to update the DOD instruction in order to address the duplication problem?

Secretary DOMINGUEZ. The Exchanges have primacy in the operation of ''fee-for-service'' personal telecommunications, including personal Internet access (email accounts, high-speed Internet service provider accounts, etc.). Authorized morale, welfare, and recreation activities may be Internet-enabled, including on-line games and ''no-fee'' Internet access in recreation, community, and library activities. The Department is in the process of publishing updates to the Exchange and Morale, Welfare, and Recreation policies to clarify the Internet access policies.

Mr. MCHUGH. The John Warner National Defense Authorization Act for Fiscal Year 2007 (Public Law 109–364) directed the Secretary of Defense to report by July 31, 2007, an evaluation of the cost effectiveness of purchasing commercial insurance to protect the financial interest in facilities operated by the Defense Commissary Agency, the Army and Air Force Exchange Service, the Navy Exchange Service Command, the Marine Corps exchanges and morale, welfare and recreation non-appropriated fund activities of DOD. Given what we heard in testimony about exploding construction costs, limitations on the availability of commissary surcharge funds and appropriated funds, it seems to me that commercial insurance may almost be a foregone conclusion. To better understand the evaluation that is being conducted, please tell me to what extent will the Department's evaluation take into account and weight in the evaluation: (1) The current trend in the explosive growth of construction costs but also future projections in construction costs for both new construction and modification to facilities; (2) The expected limited availability of appropriated or other funds (for example, the commissary surcharge fund) to respond to catastrophic loss; and, (3) A possible decreasing reliance on emergency supplemental appropriations to address unforecast losses? Beyond that, as a hedge against future catastrophic facility losses in the commissary, exchange and MWR activities, and to preserve the benefit in a predictably stressful fiscal operating environment, will DOD be considering appropriated funding for commercial insurance for such facilities?

Secretary DOMINGUEZ. In addition to the evaluation of commercial insurance, the subcommittee also requested a report on future funding to maintain and construct facilities. Because both reviews will consider escalating materials costs, the availability of appropriations, and other facility funding sources (including non-appropriated, commissary surcharge, and private financing), and operational funding, the Department plans to submit the reports together, with the FY 2008 construction program, in August 2007. The review will consider the cost effectiveness of purchasing commercial insurance with either or a combination of non-appropriated and appropriated funding.

Mr. MCHUGH. The Department of Defense Instruction (DODI) 1330.21, ''Armed Services Exchange Regulations,'' issued July 14, 2005, authorizes exchanges to operate revenue generating activities such as personal telecommunications services but does not specifically address the Internet as a revenue generating vehicle. As a result, a number of organizations at the base level are providing revenue generating Internet cafes, on-line games and other Internet based activities to service members and there appears to be considerable duplication at the base level in providing such Internet based activities. It would appear that the failure of the DOD instruction to specifically address the Internet as a revenue generating activity has left a policy vacuum. When does the Department plan to update the DOD instruction in order to address the duplication problem?

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