U.S. POSTAL REGULATORY COMMISSION

ANNUAL COMPLIANCE DETERMINATION REPORT

Fiscal Year 2012

March 28, 2013

Letter From the Chairman

Ruth Y. Goldway
Chairman

On behalf of the Postal Regulatory Commission, I am pleased to present our Annual Compliance Determination (ACD) reviewing the performance of the United States Postal Service for Fiscal Year 2012. This annual, after-the-fact review is required by the Postal Accountability and Enhancement Act (PAEA) and focuses primarily on financial transparency and compliance with pricing and service performance standards. The Postal Service's comprehensive submission and its prompt responses to all Commission requests for additional information are required in order that this ACD fulfills its regulatory role.

The Postal Service's net financial losses eroded its already precarious situation even further in FY 2012. The Postal Service incurred losses of $15.9 billion. $11.1 billion of that amount was an expense for the Retiree Health Benefits Fund (RHBF), although the Postal Service did not make this payment. $2.4 billion was due to a workers' compensation liability adjustment and $2.4 billion was attributed to operating losses. The Postal Service has reached its maximum borrowing limit and is not able to finance essential capital investments nor to adequately support needed innovations. The Postal Service has focused on reducing its costs and has undertaken ambitious restructuring plans that impact service levels.

Based on our review of information provided by the Postal Service, the Commission has determined it to be largely in compliance with postal policies and the pricing requirements of the PAEA. Notably, service performance improved for almost all classes of mail. Nevertheless, nine Market Dominant products' prices failed to raise revenue sufficient to cover even their attributable costs, causing losses of $1.5 billion, more than 50 percent of the total operating losses under management control. In particular, Standard Mail Flats revenues were $528 million less than attributable costs and Periodicals produced a $670 million loss. This ACD highlights the untapped potential of the pricing flexibility available to the Postal Service under the law.

The Postal Service can increase contribution through adjustments in worksharing arrangements and rates charged for products within a class but it has not yet fully used that flexibility. While the Postal Service has implemented certain Standard Flats rates that respond to the Commission's previous finding of non-compliance, its pricing strategy continues to result in negative contributions per piece. For Periodicals, the Postal Service has maintained a stagnant worksharing and pricing structure since FY 2007 and, in FY 2012, the contribution per piece declined.

The Commission commends and continues to support the Postal Service's efforts to innovate. In FY 2012, the Commission approved two pricing incentives designed to increase the value of the mail and slow the diversion of mail to electronic channels. The Commission also evaluated three market tests initiated in previous years and found two of them successful. The Postal Service's first Market Dominant Negotiated Service Agreement (NSA) may not be as promising. The Postal Service continued to pursue competitive NSAs, agreeing to 65 domestic NSAs and 383 international NSAs in FY 2012. And the adoption of POStPlan preserves customer access in rural communities.

In FY 2012, Congress and the Administration considered legislative action to address the Postal Service's structural problems. Senate Bill 1789 included several of the Commission's recommendations for statutory changes that would benefit the Postal Service. The Senate Bill adjusted the RHBF payment schedule to help address the Postal Service's current liquidity challenge, provided more opportunities for non-postal product offerings and clarified the scope of appellate review for Postal Service determinations to close retail facilities. We believe this ACD will help to further inform Congress's consideration of legislation in 2013.

I wish to thank Vice Chairman Robert Taub and Commissioners Mark Acton, Tony Hammond and Nanci Langley for their valuable work and contributions to this report. On behalf of my fellow Commissioners, I also want to recognize the Commission staff's outstanding efforts and dedication to our work.

Ruth Y. Goldway
Chairman

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Chapter I

Executive Summary

This report reviews the Postal Service's performance in Fiscal Year 2012, fulfilling the Commission's responsibility to produce an annual assessment of Postal Service rates and service. 39 U.S.C. 3653. It is based on information the Postal Service is required to provide within 90 days after the close of the Fiscal Year and on comments subsequently received from the public. Specific Commission findings and directives are identified at the beginning of, and italicized throughout, each chapter.

Principal Findings – Financial Performance

The Postal Service's financial situation continued to decline in FY 2012. At the end of FY 2012, the Postal Service incurred a loss of $15.9 billion. Of this, $11.1 billion was due to its Retiree Health Benefits Fund (RHBF) expense, $2.4 billion was due to a workers' compensation liability adjustment, and the remaining $2.4 billion was operating loss under management control.

For the first three years after the enactment of the Postal Accountability and Enhancement Act (PAEA), the statutorily required pre-funding of the RHBF contributed significantly to the Postal Service's financial losses. Without these payments the Postal Service would have increased, rather than decreased, its retained earnings in FY 2007 and FY 2008. The inability to generate sufficient revenues to meet its financial obligations has contributed to serious cash flow constraints. For FY 2009 through FY 2012, however, the Postal Service would not have been profitable even without these obligations.

For FY 2012, the Postal Service defaulted on its payment to the RHBF. Even without these payments, the Postal Service exhausted its statutorily defined borrowing limit. On average, 40 percent of the Postal Service's total costs are considered fixed and the severe volume losses that began in FY 2006 have continued to make it difficult for the Postal Service to generate sufficient funds to cover its fixed cost.

To remain viable, prices must be set to cover the total costs of the Postal Service. As volume declines, the fixed costs must be spread over fewer pieces. The difficulty in recovering fixed costs through pricing has led the Postal Service to find ways to substantially reduce those fixed costs. The Postal Service has proposed a new delivery schedule that includes package delivery Monday through Saturday, and mail delivery Monday through Friday. It has also begun moving forward with significantly reducing overnight and two-day service, and consolidating approximately 50 percent of its mail processing network.

Principal Findings – Pricing

Nine of the Postal Service's market dominant products failed to generate revenues sufficient to cover attributable costs, losing a total of $1.5 billion, including $642 million from Periodicals and $528 million from Standard Mail Flats.

The Postal Service has the pricing flexibility to increase contribution through worksharing incentives and rates charged for products within a class. However, the Postal Service has not adequately used this flexibility. For example, it has not changed the pricing strategy for Periodicals since FY 2007, and in FY 2012 the revenue per piece declined. Likewise, the pricing strategy for Standard Mail Flats continues to result in negative contribution per piece.

For Periodicals, the Postal Service should review its operational strategy to assess what cost savings initiatives are working and how they can be improved. The Postal Service should also review its pricing strategy to determine how to incentivize additional mailings that can be efficiently processed by current or planned operations. Since the current Periodicals pricing structure was implemented in FY 2007, neither the worksharing discounts, nor the sack, bundle or pallet charges have substantially changed. Both products in the Periodicals Class lost money during FY 2012; however, the Commission does not find the prices and fees to be out of compliance at this time. Instead, the Commission finds that the Postal Service needs to take further action to reverse the negative net revenue trend.

For Standard Mail Flats, the Commission finds that the Postal Service has begun to make progress toward addressing the issues raised by the Commission in the 2010 ACD and makes no changes to that directive. The Postal Service should continue with its proposed three-year schedule of above-average price increases and operational changes designed to reduce flats costs.

Sixteen workshare discounts were too large, as the discounts exceeded avoided costs and were not justified by a statutory exception. The Postal Service is directed to either align these discounts with avoided costs in the next market dominant price adjustment or adequately support an applicable statutory exception.

Competitive Products generated a profit amounting to 7.5 percent of the total Postal Service institutional costs. Both volume and revenue increased for Shipping and Package Services despite rate increases in excess of the Consumer Price Index (CPI). Volume increased 25 percent and revenues increased 8.7 percent. There were 63 competitive domestic Negotiated Service Agreements (NSAs) all of which appear to have covered their attributable costs and complied with the statutory requirements of section 3633(a)(2). There were 383 competitive international NSAs, of which 379 complied with the statutory requirements.

Four international competitive products failed to cover attributable costs and thus did not comply with section 3633(a)(2). Each of these products is an international Negotiated Service Agreement. The products are Global Plus 2B, Global Plus 2C, Inbound Air Parcel Post (at non-UPU rates), and International Inbound Competitive Multi-Service Agreements with Foreign Postal Operators. The Postal Service is directed to review current versions of those agreements and report to the Commission within 90 days.

Principal Findings – Service Performance

The Postal Service met its service performance targets for both Single-Piece First-Class letters and cards and Presort First-Class letters and cards, its flagship products.

While the Postal Service did not meet its delivery service standard target for the majority of market dominant products in FY 2012, it made significant improvements over the course of the fiscal year. For most of the mail volume, quarter 4 results were substantially higher than quarter 1 results.

Developing reliable measurement systems continues to present challenges to the Postal Service. Low levels of Full-Service Intelligent Mail barcode (IMb) adoption can result in unreliable service performance measurements. Although the Postal Service has made progress in increasing mailer participation in Full-Service IMb, the Commission is concerned about the low level of participation for certain Standard Mail categories, Package Services and Periodicals.

The Postal Service is also currently unable to identify the majority of Standard Mail pieces by product. This results in service performance for most of Standard Mail volume being reported as mixed product categories. The Postal Service is taking steps to address this problem and is expected to discuss its progress in identifying Standard Mail pieces by product in its next Annual Compliance Report to the Commission.

The Postal Service has announced plans to adjust overnight and 2-day service standards for First-Class Mail, realign office hours for certain small post offices, and reduce the frequency of mail delivery from six days to five days, while retaining 6-day delivery for packages. The various implications of these service changes have been discussed in previous Commission Advisory Opinions.

Chapter II

Background

Introduction

Statutory Context

Two sections of title 39, United States Code, as amended by the Postal Accountability and Enhancement Act (PAEA),[1] require the Postal Regulatory Commission to conduct ongoing, systematic reports and assessments of the financial and operational performance of the United States Postal Service. The first provision, 39 U.S.C. 3652, requires the Postal Service to file certain annual reports with the Commission, including an Annual Compliance Report (ACR). *See* 39 U.S.C. 3652(a) and (g). The second provision, 39 U.S.C. 3653, requires the Commission to review the Postal Service's annual reports and issue an Annual Compliance Determination (ACD) regarding whether rates were not in compliance with applicable provisions of the title and whether any service standards were not met. Together, these provisions establish the ACD and the ACR as integrated mechanisms for providing ongoing accountability, transparency, and oversight of the Postal Service.

Timeline and Review of Report

The Postal Service is required to file the ACR no later than 90 days after the end of each fiscal year (that is, 90 days after September 30). The Commission is required to complete the ACD within 90 days after receiving the ACR. The Postal Service filed the 2012 ACR on December 28, 2012. Thus, the Commission must issue the ACD no later than March 28, 2013.

Focus of the ACR

In accordance with 39 U.S.C. 3652, the ACR must provide analyses of costs, revenues, rates, and quality of service sufficient to demonstrate that during the reporting year all products complied with all applicable requirements of title 39. Additionally, for market dominant products, the ACR must include product information, mail volumes, and measures of quality of service, including the speed of delivery, reliability, and the degree of customer satisfaction. For market dominant products with workshare discounts, the ACR must report the per-item cost avoided by the Postal Service through the worksharing activity performed by the mailer, the percentage of the per-item cost avoided that the per-item workshare discount represents, and the per-item contribution to institutional costs. 39 U.S.C. 3652(a) and (b).

[1] Pub. L. 109-435, 120 Stat. 3198 (2006).

Other Reports

In conjunction with its filing of the ACR, the Postal Service must also file its most recent comprehensive statement on postal operations, its performance plan, and program performance reports. 39 U.S.C. 3652(g).

Commission Responsibilities

Under 39 U.S.C. 3653, the Commission is responsible for providing an opportunity for public comment on the Postal Service's submission, making a written determination as to whether any rates or fees were not in compliance with applicable provisions of chapter 36 of title 39, United States Code, or related regulations, and whether any service standards were not met. 39 U.S.C. 3653(a) and (b). If a determination of non-compliance is made, the Commission is directed to take such action as it deems appropriate. 39 U.S.C. 3653(c). The Commission is also required to evaluate annually whether the Postal Service has met the goals established under sections 2803 and 2804 and may make recommendations to the Postal Service related to the protection or promotion of the public policy objectives of title 39. 39 U.S.C. 3653(d).

Procedural History

On December 28, 2012, the Postal Service filed its 2012 ACR, covering the period from October 1, 2011, through September 30, 2012. The ACR includes an extensive narrative discussion and a substantial amount of detailed public and non-public information contained in library references. The library references include the Cost and Revenue Analysis (CRA), the International Cost and Revenue Analysis (ICRA), cost models supporting workshare discounts, and volume information presented in billing determinants. Library Reference USPS-FY12-9 summarizes the other materials included in the ACR submission and contains a list of special studies and a discussion of obsolescence[2] in response to 39 C.F.R. 3050.12.

The Postal Service concurrently filed its 2012 Comprehensive Statement on Postal Operations, which included the Postal Service's 2012 Annual Performance Report and 2013 Performance Plan.[3] Additionally, the Postal Service filed its annual report to the Secretary of the Treasury regarding the Competitive Products Fund, as required by 39 U.S.C. 2011(i), as part of Library Reference USPS-FY12-39.

On January 2, 2013, the Commission issued an order providing notice of the Postal Service's filing of the ACR and an opportunity for public comment, establishing Docket No. ACR2012 as a formal docket to consider the ACR, and appointing a Public Representative to represent the interests of the general public.[4] It established February 1, 2013, as the deadline for comments and February 15, 2013, as the deadline for reply comments.

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2 In this regard, obsolescence refers to studies that may be outdated, e.g., a study may not reflect current operating conditions and procedures.

3 2012 Comprehensive Statement of Postal Operations, December 28, 2012. This document was filed as Library Reference USPS-FY12-17. It contains information required by the Postal Reorganization Act of 1970 (PRA), the PAEA, and chapter 28 of title 39, as added by the Government Performance and Results Act of 1993, P.L. 103-62; 107 Stat. 292.

4 *See* Notice of Postal Service's Filing of Annual Compliance Report and Request for Public Comments, January 2, 2013 (Order No. 1609); see also 78 FR 1276-1277 (January 8, 2013).

Methodology Changes

The Postal Service reports that the 2012 ACR generally uses the methodologies applied in the 2011 ACR, except in cases where methodology changes were approved by the Commission after the 2011 ACR or were pending before the Commission at the time the 2012 ACR was filed. The Postal Service identifies 13 approved changes and 1 pending change. The approved changes were incorporated into the 2012 ACR. Where the pending change affected material in the ACR, the Postal Service generally included a version of the materials incorporating the pending change and a version that does not incorporate the change. The Postal Service requests that the Commission provide each model used in the preparation of the 2012 ACD at the time the 2012 ACD is issued, in order to ensure that the most up-to-date models are used in the 2013 ACR.

Product Analysis

The Postal Service provides an analysis of each market dominant product, including special services provided and domestic and international negotiated service agreements entered into during FY 2012. This analysis includes a discussion of workshare discounts and passthroughs for market dominant products, required by 39 U.S.C. 3652(b). The Postal Service also provides data for competitive products and discusses the data with reference to standards under 39 U.S.C. 3633 and 39 C.F.R. 3015.7. Finally, the Postal Service discusses the four market dominant market tests and one competitive market test conducted in FY 2012, as well as two market dominant and nine competitive nonpostal products.

Service Performance

The ACR includes information regarding service performance, customer satisfaction, and consumer access, as required under 39 U.S.C. 3652 and 39 C.F.R. Part 3055.

Confidentiality

Commission rules require the Postal Service to apply for non-public treatment when it considers information required in periodic reports to be commercially sensitive. 39 C.F.R. 3007.20. An application for non-public treatment must specify reasons for concluding the particular information is commercially sensitive and detail the nature of the competitive harm that public disclosure is likely to cause. The ACR includes such an application with respect to certain competitive products.

Requests for Additional Information

Twelve Chairman's Information Requests (CHIRs) were issued with respect to the ACR during the period beginning January 4, 2013, and ending March 8, 2013. The Postal Service responded to the CHIRs, often filing supplemental information in support of the responses. The Commission appreciates the Postal Service's responsiveness to the CHIRs.

Chapter III

Legal Issues

Introduction

Commenters raise several legal issues: (1) whether the Commission is required to make a finding of collective non-compliance of those products that have failed to recover their attributable costs since FY 2008; (2) whether Standard Mail Flats remain out of compliance with title 39, and the related issue of whether High Density/Saturation letters are unlawfully overpriced; (3) whether workshare discounts for nonprofit Standard Mail are unduly discriminatory; and (4) whether the Periodicals class complies with title 39 notwithstanding its continuing failure to cover costs.

Noncompensatory Products Since FY 2008

Background

Beginning in FY 2008, seven products have failed to generate revenues that cover their attributable costs.[1] The facts and circumstances surrounding each of these products were analyzed in the ACDs for each of the fiscal years from FY 2008 through FY 2011. *See, e.g.*, 2008 ACD at 58; 2009 ACD at 75; 2010 ACD at 94; and 2011 ACD at 105-106 (Periodicals). In each of those ACDs, the Commission identified steps intended to move those noncompensatory products toward full cost-coverage. *Id.*

Comments

Valpak asserts that the Postal Service's current financial problems are due largely to "self-inflicted" losses from the seven products with consistent losses. Valpak Comments at 33-38. Valpak argues that the Commission should make a finding of collective non-compliance with respect to those seven products. *Id.* at 37-38.[2] It bases its argument on its reading of 39 U.S.C. 3653(b) and upon the Commission's order on remand in the 2010 ACR proceedings.[3] Section 3653(b) provides that the Commission:

> shall make a written determination as to – (1) whether any rates or fees in effect during such year (for products individually or collectively) were not in compliance with applicable provisions of this chapter (or regulations promulgated) thereunder….

[1] Those seven products are: Inbound International Single-Piece First-Class Mail; Standard Mail Flats; Standard Mail NFMs and Parcels; Periodicals Within County; Periodicals Outside County; Single-Piece Parcel Post; Media and Library Mail. *See* Docket No. ACR2008, Annual Compliance Determination, March 30, 2009 (2008 ACD); Docket No. ACR2009, Annual Compliance Determination, March 29, 2010 (2009 ACD); Docket No. ACR2010, Annual Compliance Determination, March 29, 2011 (2010 ACD); and Docket No. ACR2011, Annual Compliance Determination, March 28, 2012 (2011 ACD).

[2] Earlier in its comments, Valpak states that eight market dominant products collectively violate requirements of title 39. *Id.* at 33. Those eight products appear to be the seven products identified in note 1, *supra*, together with First-Class Parcels. *Id.*; *see also id.* at 35 (Table II-2, column headed "FY 2012 Deficit (million)").

[3] Docket No. ACR2010-R, Order on Remand, August 9, 2012 (Order No. 1427).

Valpak argues that although the Commission has in all prior ACDs evaluated compliance for products "individually," not "collectively," section 3653(b) requires compliance determinations on a collective basis as well. Valpak Comments at 33.[4]

Valpak seeks to support its interpretation of section 3653(b) by citing the Commission's statement in Order No. 1427 that "[r]ates that do not cover a product's attributable costs …are subject to more careful scrutiny by the Commission because, among other things, any shortfall shifts burdens onto other mailers...[and that the]…totality of circumstances presented is critical to Commission evaluations under section 3653." *Id.* at 36 (emphasis omitted). Valpak argues that the "totality of circumstances" includes the collective magnitude, duration, and impact of the revenue shortfalls of the seven products it identifies, as well as the Postal Service's failure to take adequate steps or to develop a plan to make these products profitable. *Id.* at 36-37.

The American Catalog Mailers Association (ACMA) opposes Valpak's suggestion that the elimination of losses by means of adjustments to the rates of all products that have failed to cover their attributable costs during the past five years will virtually eliminate Postal Service operating losses. ACMA Reply Comments at 3-5. ACMA's position is based on the contention that under price cap regulation the net effect of price adjustments within a class results in price increases for some products and price decreases for others with no demonstrable causal link between an overall revenue deficit and any specific product or group of products. *Id.*

Time Inc. (Time) responds to Valpak's "theory of collective responsibility" by arguing that Valpak has misinterpreted the statutory language of section 3653(b), has proposed a concept of collective responsibility that is either a redundancy or inconsistent with logic or principles of fairness, and misapplies the "totality of circumstances" test as articulated in Order No. 1427. Time Reply Comments at 12-15.

Assuming that the term "collectively" as used in section 3653(b) is, as Valpak argues, broad enough to authorize a compliance analysis that assesses groups of products, the Commission concludes that the record does not support a finding that the noncompensatory products identified by Valpak are, as a group, non-compliant. Nor does the Commission accept Valpak's application of the "totality of circumstances" test set forth in Order No. 1427.

Valpak's allegations of collective non-compliance are based solely on the fact that eight market dominant products do not cover their attributable costs, that seven of those same products have lost money in each of the last 5 years, and that the losses from noncompensatory products have constituted almost two-thirds of the Postal Service's operating loss over those same 5 years. Valpak Comments at 33-34.

While product losses are an important consideration in determining compliance with applicable statutory requirements, the Commission has consistently maintained that a product losing money does not, by itself, necessarily require a finding of non-compliance. *See, e.g.,* 2010 ACD at 17 ("A finding that a product (*either individually or collectively*) fails to satisfy a provision of title 39 does not compel a finding of non-compliance. In making its

[4] Valpak identifies 3 possible meanings of the term "collectively" in section 3653(b): (1) all market dominant products; (2) all products within a class; and (3) "all products that perennially lose money and together are a financial threat to the Postal Service's survival as a financially independent entity…." It is the third possible meaning that Valpak uses as a basis for its claims. *Id.*

determination, the Commission must take into account numerous sometimes conflicting considerations." (emphasis added)); and Order No. 1427 at 14 ("a finding that a product or class fails to satisfy a provision of title 39, including the cost coverage factor of 39 U.S.C. 3622(c)(2), does not compel a finding of noncompliance.").

Other relevant factors in a compliance determination include: differences in the circumstances of products showing a loss; the specific reason(s) for the losses; the magnitude and trend of losses; the steps suggested by the Commission to reduce the losses; and the Postal Service's response to the losses and the Commission's suggestions for reducing those losses. *See* Order No. 1427. Valpak offers no reason, and the Commission finds none, for ignoring these other relevant factors in assessing allegations of collective non-compliance.

A review of the products which Valpak alleges to be collectively non-compliant reveals significant factors that lead the Commission to reject a finding of non-compliance notwithstanding the losses produced by those products. Together, the other relevant factors affecting each of the products in the group challenged by Valpak effectively preclude the finding of collective non-compliance that Valpak seeks to establish by means of cumulative noncompensatory product losses.

First Class Parcels

In FY 2012, cost coverage fell to approximately 98.5 percent. *See* Chapter VII, *infra.* The Postal Service attributes the decline to the transfer of commercial First-Class Parcels to the competitive product list. Prices for retail First-Class Parcels were increased by an above-average of 5 percent during January 2013. The Commission has urged the Postal Service to improve cost coverage through cost reductions and future rate adjustments.

Inbound International Single-Piece First-Class Mail

This product is discussed in Chapter VII, *infra.* As explained there, revenue from this product is subject to a unique pricing regime. Prices are based upon a Universal Postal Union (UPU) pricing formula renegotiated once every four years. The Postal Service does not independently determine prices to be paid by foreign postal operators for delivering foreign origin mail. The current UPU formula is noncompensatory for inbound letterpost entering the United States. During the past few years, the United States has sought revisions to the UPU formula. Negotiations concluded in 2012 have resulted in the adoption of a new formula to be effective during Calendar Year 2014 which should significantly improve cost coverage for this product. During the same period that the Postal Service has been pursuing improvements in the UPU formula, it has been attempting to negotiate bilateral or multilateral rate agreements with foreign postal operators as an alternative to UPU formula rates. The inclusion of Inbound International Single-Piece First-Class Mail in a group subject to a finding of collective non-compliance, as urged by Valpak, will not bind the UPU or any foreign postal operator nor would it improve the Postal Service's ability to cover its attributable costs for this product.

Standard Mail

The two Standard Mail products included in the group cited by Valpak are Standard Mail Flats and Standard Mail Not Flat-Machinable (NFMs) and Parcels. Standard Mail Flats are discussed below and in Chapter VII, *infra.* For the reasons set forth more fully in Chapter VII, the Commission concludes that other relevant factors preclude a finding of non-compliance for Standard Mail Flats on the basis of product losses alone.

At the request of the Postal Service, the market dominant product Standard Mail NFMs and Parcels was renamed Standard Parcels and was divided into two categories. See Chapter VII, *infra.* One of those two categories was moved to the competitive product list on January 22, 2012.[5] The other category remained a market dominant product. As discussed in Chapter VII, *infra*, cost coverage for that market dominant product, Standard Parcels, improved during FY 2012. Between FY 2011 and FY 2012, losses were cut more than 50 percent from a loss of $111.7 million to a loss of $48.9 million. In Docket No. R2013-1, the Postal Service proposed and the Commission approved the fifth consecutive above-average price increase of this product. That increase became effective in FY 2013. In Chapter VII, the Commission urges the Postal Service to continue to give the Standard Mail Parcels product above-average price increases and to reduce its costs.

Periodicals

The Periodicals class consists of two products, Periodicals-Within County and Periodicals-Outside County.[6] Both products lost money during FY 2012. For the reasons set forth below and in Chapter VII, *infra*, the Commission does not find the prices and fees for those two products to be out of compliance at this time. However, the Commission does find that the Postal Service needs to take further action to reverse Periodicals negative net revenue trend.

Package Services

The Package Services class contains five products, three of which are included on Valpak's list of loss-generating market dominant products. Valpak Comments at 35, Table II-2. Those three products are Single-Piece Parcel Post, Bound Printed Matter Parcels, and Media and Library Mail. *Id.*

As explained in Chapter VII, *infra*, the cost coverage for Single-Piece Parcel Post increased by approximately 2.9 percent in FY 2012. Losses decreased from $88 million in FY 2011 to $66 million in FY 2012. Following the close of FY 2012, most of Single-Piece Parcel Post was removed from the market dominant product list. The remaining subcategory of Single-Piece Parcel Post, Alaska Bypass Service, was added as a Package Services product offering. Moreover, the Single-Piece Parcel Post product was eliminated from the market dominant product list. *See* Chapter VII, *infra*. Because of these changes, the Commission expects the cost coverage of Package Services as a whole to improve.

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5 *See* Docket No. MC2010-36, Order No. 689, Order Conditionally Granting Request to Transfer Commercial Standard Mail Parcels to the Competitive Product List, March 2, 2011; Docket No. CP2012-2, Order No. 1062, Order Approving Changes in Rates of General Applicability for Competitive Products, December 21, 2011.

6 The Postal Service notified the Commission in Docket No. RM2011-8 that it is changing the name of Within County to In-County. A final order has not been issued in that docket. The terms Within County and In-County are used interchangeably in this ACD.

The second Packages Services product included on Valpak's list of loss-generating market dominant products is Bound Printed Matter Parcels. In FY 2012, Bound Printed Matter Parcels covered its attributable costs and made a contribution to institutional costs. *Id.*

The third and final Package Services product which Valpak includes on the list of loss-generating products is Media and Library Mail. Valpak Comments at 35. During FY 2012, cost coverage improved by over 8 percent. *See* Chapter VII, *infra*. Between FY 2011 and FY 2012, losses on this product were reduced by over 40 percent from $98 million to $55 million. Valpak Comments at 35. The Postal Service has proposed above-average price increases in its most recent price adjustment cases and asserts that its cost savings initiatives are expected to improve cost coverage. *See* Chapter VII, *infra*. The Commission is encouraging the Postal Service to continue pricing Media and Library Mail in a way that improves cost coverage. *Id.*

Even assuming it were appropriate to review collectively the products identified by Valpak, the factors discussed above both explain and support the Commission's conclusion that these products are not out of compliance notwithstanding the collective losses cited by Valpak.

Finally, Valpak fails to satisfy the "totality of circumstances" test discussed in Order No. 1427. It cannot be said that the Postal Service has not attempted any meaningful steps to make profitable each of the seven products at issue. For example, in the case of NFMs/Parcels, "the Postal Service has responded to cost coverage shortfalls by proposing above-average rate increases and the transfer of mail into competitive products that allow additional pricing flexibility." Order No. 1427 at 19.

Valpak's allegations are too broadly formulated and too narrowly supported to sustain a finding of collective non-compliance.

Standard Mail Flats

Background

On March 29, 2011, the Commission issued its 2010 ACD. The Commission concluded that because of the Postal Service's failure to address the increasing cost contribution shortfall of the Standard Mail Flats product, the prices in effect in FY 2010 amounted to an unfair and inequitable apportionment of costs in violation of 39 U.S.C. 101(d). 2010 ACD at 106.

Pursuant to the authority in 39 U.S.C. 3653(c), the Commission directed the Postal Service to increase the cost coverage of the Standard Mail Flats product through a combination of above-average price adjustments and cost reductions until such time that the revenue for the product exceeds attributable costs. *Id.* The Commission further directed the Postal Service to present a schedule of future above-CPI price increases for the Standard Mail Flats product, with the schedule to be updated with each subsequent market dominant price adjustment and ACR. Finally, the Commission ordered the Postal Service to provide certain additional information in subsequent ACRs and notices of market dominant price adjustments until the revenue for the product exceeds attributable costs. *Id.* at 107.

The Postal Service subsequently petitioned the United States Court of Appeals for the District of Columbia Circuit for review of the 2010 ACD. While the appeal was pending, the Commission granted a Postal Service motion to stay that portion of the 2010 ACD requiring the Postal Service to present a schedule of above-CPI price increases.[7] The stay was to remain in effect until 30 days following resolution of the Postal Service's appeal.

On March 28, 2012, the Commission issued its 2011 ACD. In it, the Commission found that the rates and fees for Standard Mail Flats remained out of compliance and, that Standard Mail prices continued to reflect an unfair and inequitable apportionment of the costs of postal operations to all Standard Mail users. 2011 ACD at 118-119. However, because of the continued pendency of the litigation regarding the 2010 ACD, the Commission did not require additional remedial action at that time. *Id.* at 119.

D.C. Circuit Opinion

On April 17, 2012, the United States Court of Appeals for the District of Columbia Circuit issued its opinion in *United States Postal Service v. Postal Regulatory Commission*, 676 F.3d 1105 (D.C. Cir. 2012). This opinion addressed issues raised by the Postal Service in its appeal of the Commission's FY 2010 ACD.

On appeal, the Postal Service had argued that by relying on the mandate in section 101(d), the Commission had improperly looked beyond the criteria prescribed by 39 U.S.C. 3622(c) for market dominant products, which include Standard Mail Flats. 676 F.3d at 1107. The Court rejected that contention and upheld the Commission's finding that section 3622(c)(14), which governs market dominant products, permits the Commission to consider the general standards of section 101(d) in an Annual Compliance Determination, "at least in extreme circumstances." *Id.* at 1108.

The Postal Service's second contention was that the remedy prescribed by the Commission for Standard Mail Flats was arbitrary and capricious because it was inconsistent with the Commission's treatment of other market dominant products having comparable, or lower, cost coverages. *Id.* The Court remanded the case to the Commission to clarify its "definition of the circumstances that trigger § 101(d)'s failsafe protection [*i.e.*, the requirement of "fair and equitable" cost apportionment], and for an explanation of why the particular remedy imposed…[with respect to Standard Mail Flats]…is appropriate to ameliorate that extremity….". *Id.*

On August 9, 2012, the Commission issued its order on remand in which it concluded that not all rates that fail to cover a product's attributable costs must necessarily be deemed to be out of compliance and subject to remedial action. Order No. 1427 at 4. However, rates that fail to cover a product's attributable costs are subject to more careful scrutiny because any shortfalls will shift burdens onto other mailers. *Id.* Such scrutiny under section 101(d)'s fair and equitable standard involves consideration of the totality of circumstances. *Id.* After reviewing the history of proceedings leading up to the Commission's 2010 ACD, the Commission identified specific factors which, in the case of Standard Mail Flats, constituted extreme circumstances triggering section 101(d)'s protections. *Id.* at 4-9.[8] The Commission explained further that additional factors could emerge in other cases that would support a finding

[7] Docket No. ACR2010, Order Granting Stay, May 27, 2011 (Order No. 739).

[8] The factors identified by the Commission were: a significant and growing cost coverage shortfall; the duration of the shortfall over a significant period; evidence that the cost coverage shortfall was likely to increase further; a significant adverse impact on users of other mail products (some of whom could be competitors of mailers of the subsidized mail product) requiring subsidization of the non-complying product; failure of the Postal Service to address the shortfall by rate increases, cost increases, or a combination thereof, despite the capability to do so; and the failure of the Postal Service to provide an adequate explanation for not taking necessary remedial steps designed to ameliorate the cost coverage shortfall. *Id.* at 9.

of extreme circumstances requiring remedial action. *Id.* Such additional factors would be identified on a case-by-case basis.

In responding to the Court's directive that it explain the appropriateness of its Standard Flats remedy, the Commission first discussed how that remedy expressly addressed the reasons Standard Mail Flats was not in compliance with section 101(d) (*i.e.*, the growing negative contribution; the increasing disparity with Standard Mail letters; and the failure of the Postal Service to take steps to remedy the problem). *Id.* at 13. The Commission next explained that slightly less than complete cost coverage might be adequate to avert further remedial action, provided the Postal Service had taken adequate steps either to eliminate the shortfall or to explain the shortfall. *Id.* Finally, the Commission explained why its treatment of Standard Mail Flats was consistent with its treatment of the Standard NFMs/Parcels product and Periodicals. *Id.* at 14-18. The Commission concluded by explaining why the differences in treatment were justified by differences in the circumstances of those products. *Id.* at 19-20.

On September 21, 2012, the Commission issued an order confirming termination of the stay it had previously granted pending resolution of the Postal Service's appeal.[9] In that same order, the Commission directed that as part of its 2012 ACR the Postal Service should respond to the specific remedy adopted by the 2010 ACD by presenting a schedule of future price adjustments for Standard Mail Flats. *Id.* at 3. In addition, the Postal Service was directed to provide in its next ACR and market dominant price adjustment the information on general remedial actions that had been required by the 2010 ACD. *Id.*

FY 2012 Compliance

In FY 2012, the Postal Service increased prices for the Standard Mail Flats product by 2.209 percent, slightly more than the 2.041 percent increase in prices for Standard Mail overall.[10] The cost coverage for the Standard Mail Flats product has increased from 79.3 percent in FY 2011 to 80.9 percent in FY 2012. 2012 ACR at 15. The Postal Service again states its agreement with the Commission that having products cover their costs is an appropriate long-term goal. *Id.* Finally, the Postal Service identifies programs that have restrained cost increases and presents a three-year schedule of above-CPI increases for the Standard Mail Flats product in purported compliance with the Commission's 2010 ACD and Order No. 1472 directing that specific remedial actions be taken. *Id.* at 15-19.

Six parties filed comments addressing the Standard Mail Flats compliance issue: Valpak, ACMA, the Direct Marketing Association (DMA), the Association for Postal Commerce (PostCom), the Postal Service, and the Public Representative. Their positions are summarized below and the arguments presented in support of those positions are further discussed in Chapter VII, *infra*.

In its initial and reply comments, Valpak argues that Standard Mail Flats are out of compliance. Valpak Comments at 38-107; Valpak Reply Comments at 4-36. In a related argument, Valpak asserts that the Postal Service's pricing of High Density/Saturation Letters also violates the PAEA. Valpak Comments at 107-122.

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9 Docket No. ACR2010-R, Notice and Order Confirming Termination of Stay, September 21, 2012 (Order No. 1472).

10 Docket No. R2012-3, Order on Price Adjustments for Market Dominant Products and Related Mail Classification Changes, November 22, 2011, at 19-20 (Order No. 987).

The Public Representative joins Valpak in criticizing the Postal Service's efforts to reduce costs and increase prices and recommends that the Commission require the Postal Service to make a greater effort to reduce the costs of Standard Flats and report the effect of those efforts in next year's ACR. PR Comments at 32-38; PR Reply Comments at 19-31.

In their initial comments, ACMA and DMA oppose the finding of non-compliance advocated by Valpak and the Public Representative. ACMA Comments at 2-33; DMA Comments at 1-2. In reply comments, ACMA, the Postal Service, and PostCom also oppose a finding of non-compliance. ACMA Reply Comments at 5-12; Postal Service Reply Comments at 5-14; PostCom Reply Comments at 1-5.

The Commission finds that, under current circumstances, the Postal Service is making reasonable progress toward addressing the issues raised in the 2010 ACD, that no changes in the 2010 ACD directive are necessary, and that the Postal Service should proceed with its proposed three-year schedule of price increases and operational changes to reduce flats costs. See discussion in Chapter VII.

Valpak's related claim that the pricing of High Density/Saturation Letters violates the PAEA is but an extension of its claim that Standard Mail Flats are not in compliance. Thus, Valpak views the unjustified preference allegedly enjoyed by Standard Mail Flats in violation of 39 U.S.C. 403(c) as the alleged cause of unfair discrimination against High Density/Saturation Letters under that same section 403(c), as well as an unfair allocation of costs to High Density/ Saturation Letters in alleged violation of 39 U.S.C. 101(d). Valpak Comments at 121. These alleged pricing disparities are, in Valpak's view, also a violation of 39 U.S.C. 3622. The Commission is not persuaded by these arguments.

On review of the information relied upon by Valpak in this proceeding, the Commission does not find the Postal Service's pricing of High Density/Saturation Letters to be an unreasonable exercise of its pricing authority. Title 39 gives the Postal Service pricing flexibility for market dominant products. That pricing flexibility is guided by nine objectives and 14 factors and is not limited to a cost-based or demand-based approach. In exercising its pricing flexibility, the Postal Service must engage in a balancing process. The fact that the cost coverage of one product exceeds the system average while another product is below the system average does not render the price of either unlawful. Under section 3622, prices are influenced by various, sometimes competing factors and objectives. By themselves, differences in product prices and resulting cost coverages do not demonstrate that prices are in violation of sections 403(c) or 101(d). *Therefore, the Commission finds the pricing of High Density and Saturation Letters to be reasonable.*[11]

[11] The National Postal Policy Council (NPPC) and Pitney Bowes, Inc. argue that Presort First-Class Mail is being improvidently overpriced. NPPC Comments at 2; and Pitney Bowes Comments at 1-4. For the reasons set forth in Chapter VII, the Commission finds that the information provided in their comments is not adequate to support a finding that the difference in price increases applied to categories within First-Class is unreasonable.

Workshare Discounts for Nonprofit Standard Mail

Background

On October 18, 2011, the Postal Service filed a notice of a market dominant price adjustment to be effective on January 22, 2012.[12] Among the adjusted prices were prices for nonprofit Standard Mail. *Id.* at 30. Both commercial and nonprofit Standard Mail were subject to workshare discounts. *Id.* at 36-47. The Commission's notice of the Postal Service's filing was issued on October 21, 2011.[13] None of the comments filed in response to that notice addressed the propriety of the workshare discounts for nonprofit Standard Mail. On November 22, 2011, the Commission issued an order which, *inter alia*, concluded that the "workshare discounts either satisfy the requirements of 39 U.S.C. 3622(e) or fall within an enumerated exception to those requirements, and may take effect." Order No. 987 at 51, Ordering Paragraph 3.

Almost one year later, on October 11, 2012, the Postal Service filed a notice of its FY 2013 market dominant price adjustment to be effective on January 27, 2013.[14] In the course of reviewing that filing, the Commission identified differences in the workshare discounts for commercial and nonprofit Standard Mail. An October 31, 2012, information request asked the Postal Service to explain those differences.[15] The Alliance of Nonprofit Mailers (ANM) challenged the Postal Service's response to Docket No. R2013-1, CHIR No. 5 as inadequate to justify the disparity between the commercial and nonprofit discounts relying upon the anti-discrimination provisions of 39 U.S.C. 403(c) and the decision in *National Easter Seal Society v. USPS*, 656 F.2d 754 (D.C. Cir. 1981).[16] After reviewing the Postal Service's subsequent explanation of why the differing commercial and nonprofit Standard Mail discounts were lawful[17] and ANM's response,[18] the Commission found that in the circumstances presented, the different discounts were permissible, but specifically directed that "[i]n future rate adjustment proceedings, the Postal Service must continue to identify in its workpapers when nonprofit workshare discounts differ from their commercial counterparts and to justify deviations from the discounts applied to commercial mail."[19] Order No. 1573 has been appealed to the United States Court of Appeals for the District of Columbia Circuit.[20]

FY 2012 Compliance

The Postal Service's 2012 ACR contains no discussion of differences between workshare discounts for commercial and nonprofit Standard Mail.

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12 Docket No. R2012-3, United States Postal Service Notice of Market-Dominant Price Adjustment, October 18, 2011, at 1 (2012 Market Dominant Price Adjustment).

13 Docket No. R2012-3, Order No. 921, Notice and Order on Planned Rate Adjustments and Classification Changes for Market Dominant Postal Products, October 21, 2011.

14 Docket No. R2013-1, United States Postal Service Notice of Market-Dominant Price Adjustment, October 11, 2012, at 1 (2013 Market Dominant Price Adjustment).

15 Docket No. R2013-1, Chairman's Information Request No. 5, October 31, 2012, questions 8-13 (Docket No. R2013-1, CHIR No. 5).

16 Docket No. R2013-1, Reply of Alliance of Nonprofit Mailers to USPS Responses to Chairman's Information Request No. 5, Questions 8-13, November 13, 2012.

17 *See* Docket No. R2013-1, United States Postal Service Response to Order No. 1541, November 26, 2012.

18 *See* Docket No. R2013-1, Comments of Alliance of Nonprofit Mailers on USPS Compliance Filing, December 4, 2012.

19 Docket No. R2013-1, Order No. 1573, Order on Standard Mail Rate Adjustments and Related Mail Classification Changes, December 11, 2012.

20 *Alliance of Nonprofit Mailers v. PRC*, D.C. Cir. No. 13-1006 (Petition for Review filed January 10, 2013) (*ANM v. PRC*).

Parties' comments

In its comments, ANM challenges the differences between the workshare discounts of commercial and nonprofit Standard Mail and requests the Commission: (1) to confirm that the relationship between commercial and nonprofit workshare discounts in Standard Mail continues to be governed by 39 U.S.C. 403(c) and *National Easter Seal Society (NESS)*; (2) to find that the workshare discounts offered to nonprofit Standard Mail during FY 2012 did not satisfy those standards; and (3) to make the same finding for the workshare discounts for nonprofit Standard Mail approved in Docket No. R2013-1. ANM Comments at 26. In reply comments, the Public Representative urges the Commission to find the FY 2012 nonprofit Standard Mail workshare discounts out of compliance. PR Reply Comments at 31-34. The Public Representative bases his recommendation on reasons essentially the same as those offered by ANM. *Id.*

The Postal Service argues that it would be arbitrary and capricious for the Commission to find the FY 2012 workshare discounts for nonprofit Standard Mail to be out of compliance absent new information or a change in circumstances; and that the nonprofit workshare discounts contained in the R2013-1 Market Dominant Price Adjustment were not in effect in FY 2012 and, therefore, are outside the scope of the current proceeding. Postal Service Reply Comments at 17-18.

After filing their respective comments, ANM and the Postal Service filed a joint motion on March 13, 2013, requesting the Commission prospectively to adopt standards governing the pricing of worksharing discounts for nonprofit Standard Mail.[21] The requested standards state:

> In any future case in which the Postal Service proposes to establish a worksharing discount for nonprofit Standard Mail that differs from the corresponding discount for commercial Standard Mail:
>
> 1. The Postal Service's notice of price adjustment shall:
>   — Identify each instance in which the proposed nonprofit discount differs from the corresponding commercial discount;
>   — Provide the Postal Service's justification(s) for each difference.
> 2. The Commission will review the rates established by the Postal Service in paragraph (1), above, in accordance with 39 U.S.C. § 403(c) and the Court of Appeals' decision in *National Easter Seal Society for Crippled Children and Adults v. United States Postal Service*, 656 F.2d 754 (D.C. Cir. 1981).
> 3. The Commission's decisions in Docket No. R2013-1 and other post-PAEA price adjustment cases that approved price adjustments with unequal worksharing discounts shall not control the Commission's determination under paragraph (2), above when:
>   — the Postal Service fails to comply with paragraph (1); or
>   — the Postal Service complies with paragraph (1), but another party files a timely challenge to the lawfulness of the discounts.

[21] Joint Motion of Alliance of Nonprofit Mailers and United States Postal Service to Adopt Standards Governing Pricing of Worksharing Discounts for Nonprofit Standard Mail, March 13, 2013 (Joint Motion).

4. If the Commission finds, under paragraph (2), above, that there is no reasonable justification for the difference in discounts, the Postal Service shall provide an alternative schedule of nonprofit rates that (1) generates approximately the same total revenue as the rates proposed by the Postal Service, and (2) eliminates the noncompliance with 39 U.S.C. § 403(c) found by the Commission.

Joint Motion, Attachment A.

The Joint Motion by ANM and the Postal Service was filed on March 13, 2013. No answers were filed in opposition. Adoption of the proposed standards would resolve the controversy in this proceeding over the nonprofit workshare discounts that grew out of the prior rate proceedings in Docket Nos. R2012-3 and R2013-1, as well as the pending judicial review proceedings in *ANM v. PRC*, D.C. Cir. No. 13-1006. *Id.* at 3, paragraph 8.

As a matter of general policy the Commission encourages parties to negotiate resolutions of their disputes. Nevertheless, this is the first ACR proceeding in which participants have, in the course of debating the lawfulness of product pricing in a prior fiscal year, proposed specific standards for prospective application in future rate proceedings. The proposed standards identify a specific statutory provision, section 403(c), and a specific judicial decision, the NESS decision, as providing applicable legal criteria for evaluating workshare discounts for nonprofit Standard Mail. The proposed standards would also prohibit reliance upon certain Commission decisions in making any such evaluations. Finally, the proposed standards would prescribe actions the Postal Service would take if the Commission should determine that the Postal Service had not adequately justified differences in the discounts for nonprofit and commercial Standard Mail. This could be interpreted as impacting the Commission's options to direct other actions.

Given the background to the dispute being resolved, the specific pricing issue being presented, and the history underlying that issue, the Commission does not object to the proposed standards. However, the Commission makes it clear that its decision should not be interpreted as an abdication of its legal responsibility to administer statutory requirements that might apply in future situations should the facts so require.

Periodicals

During FY 2012, the overall cost coverage for the Periodicals class declined from 74.9 percent in FY 2011 to 72.1 percent in FY 2012. 2012 ACR at 26. Both products that comprise the Periodicals class – Within County and Outside County – reported declines. Cost coverage of Within County Periodicals fell from 78.4 percent in FY 2011 to 70.5 percent in FY 2012. *Id.* Cost coverage of Outside County Periodicals fell from 74.8 percent in FY 2011 to 72.2 percent in FY 2012. *Id.*

The revenue per piece for Periodicals overall (25.7 cents) decreased slightly (0.05 cents) in FY 2012 despite price increases in January 2012. In contrast, the Periodicals attributable cost per piece increased from 34.3 cents to 35.6 cents, or 3.7 percent. *Id.* The net effect was a lower calculated cost coverage. *Id.*

The Postal Service states that despite efforts to pursue efficiency enhancements and reduce costs, it is extremely doubtful that the Periodicals class can achieve 100 percent cost coverage using price increases limited to the CPI price-cap. *Id.* at 27.

Comments

Valpak cites growing losses during FY 2012 for the Periodicals class, the failure of prior steps to reverse those losses, and "highly speculative future cost savings," to argue that Periodicals class pricing violates several sections of title 39: section 3622(b); section 3622(c)(2); section 101(a); section 101(d); and section 403(c). Valpak Comments at 122-129. In Valpak's view, the Commission can no longer delay a finding of non-compliance. *Id.* at 129-133. Finally, Valpak renews its argument that the Commission has the statutory authority to order Periodicals price increases above the price cap. *Id.* at 133-134.

In reply comments, Time opposes both Valpak's argument that a finding of non-compliance can no longer be delayed, and Valpak's contention that increases above the CPI price-cap can be ordered. Time Reply Comments at 3-9. Time argues further that the CPI price-cap prevails and that Valpak is essentially arguing that Congress made bad choices in enacting a price-cap regulatory regime. *Id.* at 9-18.

Similarly, in joint reply comments, the Magazine Publishers of America, Inc. and the Alliance of Nonprofit Mailers (MPA/ANM) argue that the Commission has no authority to approve above-CPI rate increases for the Periodicals class. MPA/ANM Reply Comments at 3-10. According to MPA/ANM, the real problem with Periodicals is not the CPI-cap, but the Postal Service's excessive costs. *Id.* at 11-16.

The Postal Service responds to Valpak by stating its agreement that the Commission should determine the extent of its remedial powers and act accordingly. Postal Service Reply Comments at 4-5.

As discussed more fully in Chapter VII, infra, the Commission does not find the prices and fees for the Periodicals class to be out of compliance at this time. The Postal Service continues to implement steps to reduce the high costs of processing and delivering Periodicals. Operational changes begun in FY 2011 and more fully implemented in FY 2012 may still achieve expected results. Moreover, the Postal Service still has access to pricing tools to incent efficient mailings that reduce costs and increase net revenue. However, it must take further action now to address this situation. The Postal Service needs to take the initiative to identify and implement solutions to Periodicals' worsening net revenue results.

Chapter IV

Postal Service Financial Condition

Introduction

Since the enactment of PAEA the Postal Service has experienced net financial losses in each fiscal year from FY 2007 through FY 2012. As these net financial losses continue, the Postal Service will be unable to finance capital investment to replace deteriorating assets and make improvements to other capital assets to further improve productivity.

For the first 3 years after the enactment of the PAEA, the statutorily required pre-funding of the RHBF contributed significantly to the Postal Service financial losses. Without these payments the Postal Service would have increased, rather than decreased, its retained earnings in FY 2007 and FY 2008. For FY 2009 through FY 2012, however, the Postal Service would not have been profitable even without these obligations.

FY 2012 revenues were 13 percent lower than FY 2008 and while FY 2012 operating expenses, excluding the RHBF payments, were 3 percent lower than FY 2008. The decrease was not enough to offset the revenue decline. The inability to generate sufficient revenues to meet its financial obligations has contributed to serious cash flow constraints. To remain viable the Postal Service must address both revenue generation and operating costs. Maintaining or improving service is also important as a means of retaining existing volume to the extent possible.

In FY 2012, the Postal Service defaulted on $11.1 billion in RHBF payments and by all indications will not be able to make these payments in the near future. This issue requires legislative action to be resolved. Although the RHBF expenses impact the Postal Service's net income, because they were not paid in FY 2012, they did not affect the day to day financial operations of the Postal Service. Similarly, the Postal Service recognizes as an expense changes in the long-term workers' compensation liability that do not impact the current year's day-to-day operations or the current year's cash flows. The focus of this chapter is on the cash flows and the net operating expense under management control, which does not include the RHBF expense or the expense for the change in the long-term workers' compensation liability. Actions the Postal Service may take to improve its net operating financial situation are also discussed.

The Commission's 701 Report included a key recommendation: that Congress adjust the current Postal Service RHBF payment schedule.[1] The Commission remains concerned that the current payment schedule imposes unsustainable burdens on the Postal Service's financial condition, and risks impairment of the Postal Service's ability to continue to perform its statutory functions.[2]

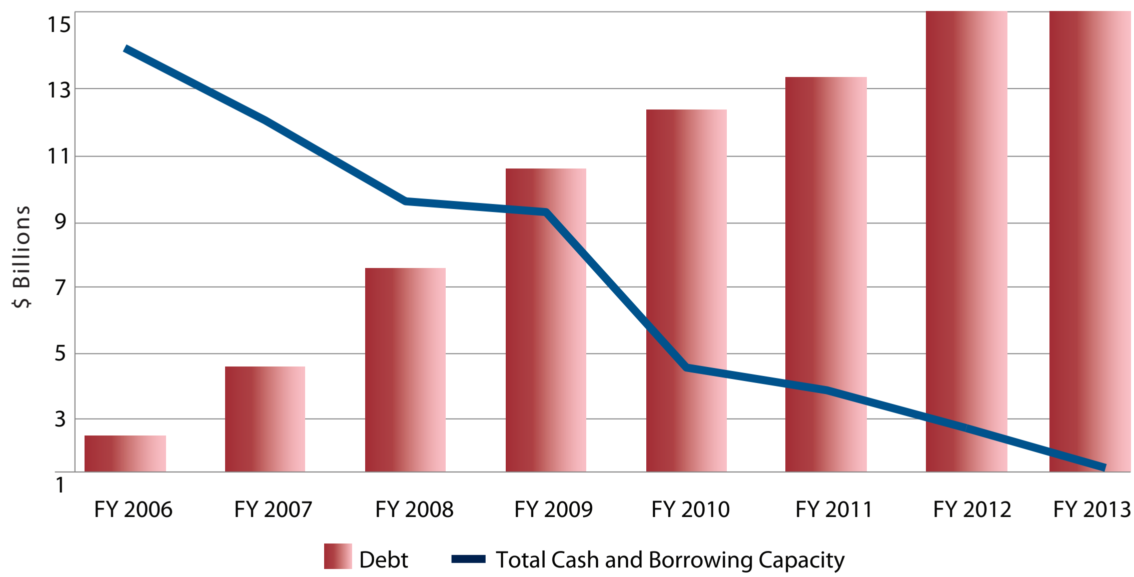
1 *See* Section 701 Report, Analysis of the Postal Accountability and Enhancement Act of 2006, September 22, 2011, at 21-24 (701 Report).

2 *See* 2011 ACD at 21.

Diminishing Cash Flows and Working Capital

Liquidity for the Postal Service comes from cash generated through operations, cash on hand at the end of the year, and borrowing capacity. In recent years the Postal Service has relied on its borrowing capacity to fund its operations and financial obligations such as the RHBF payments.[3] The Postal Service's diminishing cash balance and increasing debt is shown in Figure IV-1.

Figure IV–1—Increased Funding of Postal Operations with Debt



Source: PRC-ACR2012-NP-LR1.

Since FY 2007, the Postal Service's operations have been increasingly financed through borrowing. By the end of FY 2012, the Postal Service had exhausted its statutory borrowing limit of $15 billion and had fully drawn on its two revolving lines of credit in the amounts of $3.4 billion and $600 million.[4] Absent this borrowing, the Postal Service would have ended FY 2012 with a cash balance of approximately $300 million. The Postal Service uses $250 million on average each day to meet its expenses.[5] With the borrowing, the Postal Service had a cash balance of $2.3 billion dollars at the end of FY 2012 but no further borrowing authority.

In its FY 2013 Integrated Financial Plan (IFP), the Postal Service forecasts 4 months during the year when average available cash is projected to be at or below $1 billion, which is enough to cover only 4 days of expenses. Because the Postal Service reached its maximum borrowing capacity in FY 2012 it no longer has access to borrowing in the event of a cyclical downturn. Thus, if the key economic indicators used in the Postal Service's forecast for FY 2013 are not accurate, there is a possibility that the Postal Service would run out of cash to fund its day to day operations.

3 *See* USPS FY 2012, Form 10-K at 52.

4 *Id.* at 91 and 92.

5 "...$1.0 billion, which represents approximately four days of average daily expenses." United States Postal Service Fiscal Year 2013 Integrated Financial Plan (IFP), at 1.

The Postal Service's liquidity problems are also affecting long-term investment in maintaining and improving business assets. Capital spending has been reduced in recent years compared to historical trends. From FY 2006 – 2010 the Postal Service spent, on average, $2.1 billion annually on capital expenditures. Actual capital expenditures for FY 2011 and FY 2012 were $1.2 and $0.8 billion, respectively. The FY 2013 Integrated Financial Plan (IFP) estimates capital expenditures of $1 billion.[6] The Public Representative comments that the Postal Service's FY 2013 capital commitment plan of $1 billion is less than one–half of the recent 5 year average capital cash outlay. PR Comments at 5. Should capital spending continue to be restricted, important assets that are not being replaced will likely deteriorate due to normal wear and tear, and increase maintenance costs, and potentially impact service performance. For example, many Automated Postal Centers are reaching the end of their useful lives. *See* Chapter VI, *infra*.

Declining Volume and Revenues

As discussed below, the FY 2012 net operating loss under management control of $2.4 billion reflects continuing declines in volumes, revenue constraints due to the price cap, pricing strategies, and difficulties in lowering operating expenses.

Volume Declines

Total mail volume has declined over 8.1 billion pieces, or 5 percent in FY 2012, with First-Class Mail declining 0.2 percent and Standard Mail volume declining 5.8 percent.[7] As Figure IV-2 shows, total mail volume has declined 25 percent since FY 2006.

The recent decline in volume increasingly appears to reflect a permanent change in mailer behavior rather than a temporary result of economic activity, such as that reflected in the steep decline between FY 2007 and FY 2009. From FY 1970 to FY 2000 the growth of mail volume closely matched the growth of the United States economy. During the last 31 years of the 20th century, Gross Domestic Product (GDP) and mail volume grew at an average annual rate of 3.2 percent and 3.1 percent, respectively. Since FY 2001 however, the close relationship between GDP and mail volume growth has diverged. From FY 2000 to FY 2012, GDP grew at an average annual rate of 1.8 percent whereas mail volume declined at an average annual rate of 1.8 percent. This has created a gap of 3.6 percentage points between the average changes in the two measures. Figure IV-3 illustrates this trend.

The Postal Service cites the increase in household internet access as a major reason for the general decline in mail volumes.[8] From FY 2000 to FY 2010, the percentage of households with internet access increased from 41.5 percent to 71.1 percent. Increased internet access allows households to use internet services in lieu of traditional postal products. Other social changes such as structural changes in advertising markets and the dramatic expansion in the use of social media have been large factors in mail volume decline.

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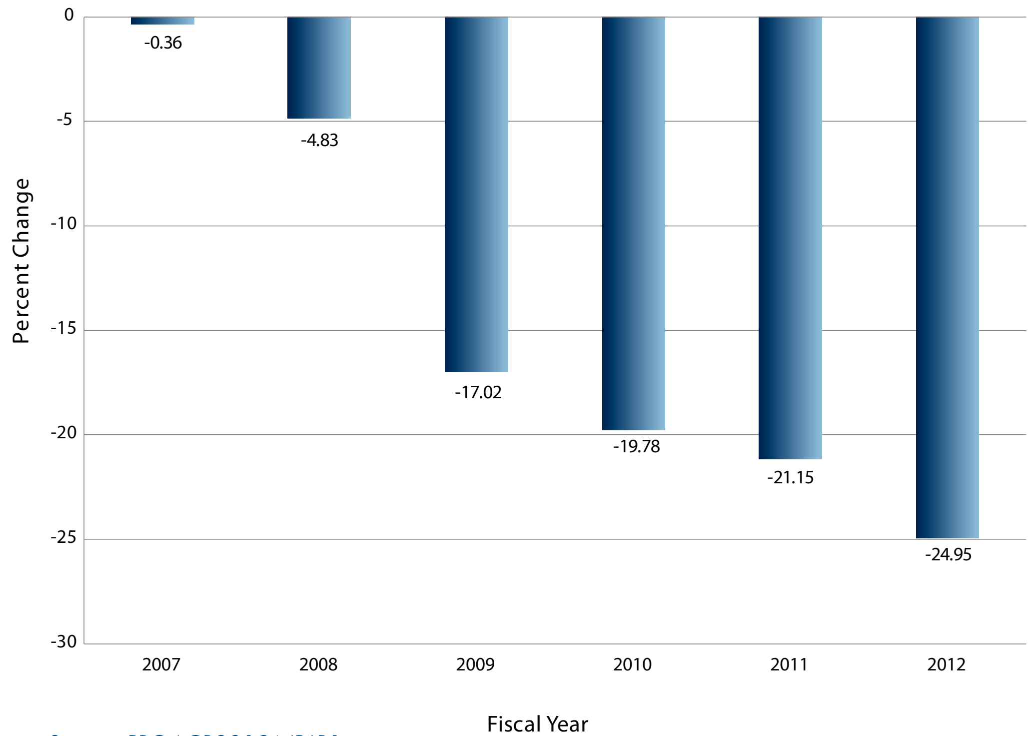
6 2013 IFP at 5.

7 PRC-ACR2012-NP-LR1

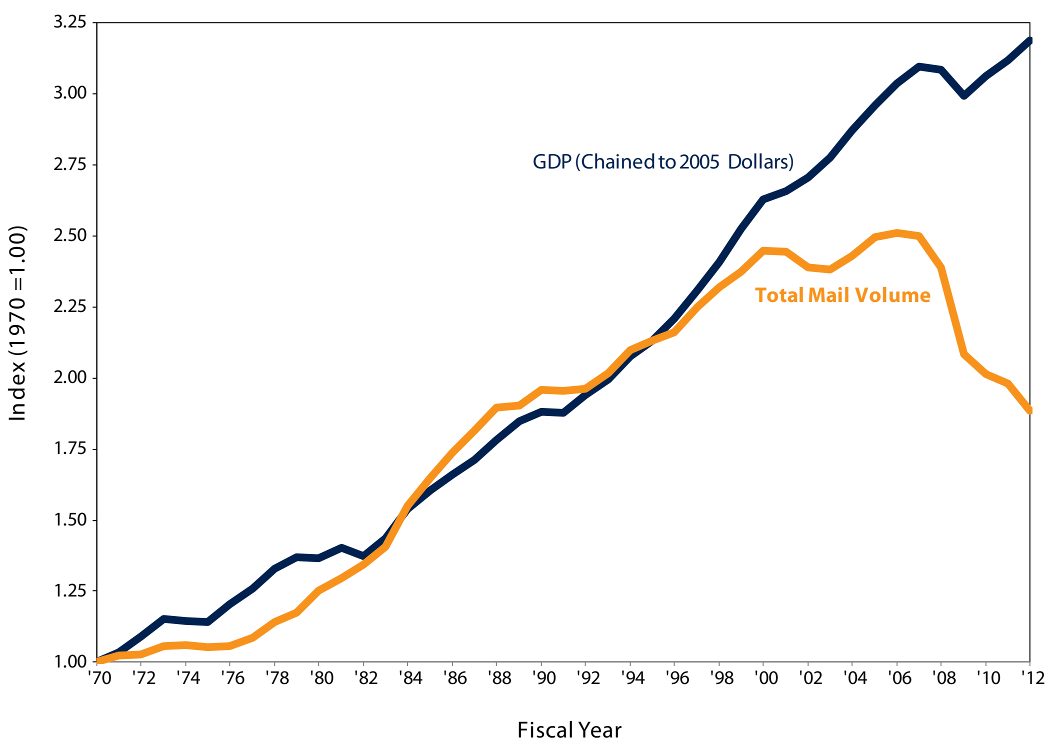
8 USPS 2012 Report on Form 10-K at 12.

Figure IV–2—Total Mail Volume Growth Rate Since FY 2006



Source: PRC-ACR2012-NP-LR1.

Figure IV–3—Gross Domestic Product (GDP) and Total Mail Volume Growth Fiscal Years 1970–2012



Source: PRC-ACR2012-NP-LR1.

Revenue Constraints Versus Pricing Flexibility

These volume declines resulted in significant reductions in revenue. In FY 2006 total revenue was $73 billion, in FY 2012 it was $65 billion, a reduction of 10.4 percent. In FY 2012, First-Class Mail revenue declined by almost $1.2 billion and Standard Mail revenue declined $0.7 billion from the prior year, a reduction of 3.9 percent and 4.3 percent respectively. This rate of decline is 1.7 percent greater in FY 2012 than in FY 2011. Table IV-1 shows mail revenue for selected categories.[9]

Table IV–1—Mail Revenues ($ in Millions)

	FY 2012	FY 2011	Increase or (Decrease)	Percent Change
First-Class	28,867	30,030	(1,163)	-3.9%
Periodicals	1,731	1,821	(90)	-4.9%
Standard Mail	16,428	17,175	(747)	-4.3%
International	2,816	2,585	231	8.9%
Other	3,785	3,430	355	10.3%
Total Mailing Services	53,627	55,041	(1,414)	-2.6%
Total Shipping and Package Services	11,596	10,670	926	8.7%
Total Mail	65,223	65,711	(488)	-0.7%

Source: USPS FY 2012 Form 10-K at 26.

The PAEA provides the Postal Service with the pricing flexibility to balance multiple objectives, including the generation of adequate revenue and the ability to retain earnings to maintain financial viability. In FY 2012, nine market dominant products failed to generate sufficient revenues to cover their direct and indirect costs. These products, shown in Table IV-2, account for $1.5 billion in losses, over 60 percent of the total operating loss under management control in FY 2012.

Table IV–2—List of Market Dominant Products and Services with Respective Negative Contribution to Institutional Costs ($ in Millions)

First-Class, Inbound Int. Single-Piece Mail International[1]	(92.8)
First-Class, Parcels	(9.6)
Standard, Flats	(527.9)
Standard, Not Flat-Machinables and Parcels	(49.0)
Periodicals, Within County	(28.1)
Periodicals, Outside County	(642.0)
Package Services, Single-Piece Parcel Post	(65.9)
Package Services, Media and Library Mail	(55.5)
Special Services, Stamp Fulfillment Services	(2.3)
Total	(1,473.2)

[1]This entry includes three international mail categories.

Source: PRC-ACR2012-LR1.

9 Prior year revenue for the products transferred in the current year is reclassified to reflect the transfer as taking place in the prior year. This adjustment isolates the impact of revenue changes occurring in FY 2012.

The Postal Service's pricing strategy may not maximize potential contribution. As discussed in detail in Chapter VII, *infra*, the Postal Service has the pricing flexibility to increase contribution from worksharing programs. However, the Postal Service has not changed the workshare relationships for Periodicals since FY 2007 and in FY 2012 the contribution per piece declined. Likewise, the pricing strategy for Standard Flats continues to result in negative contribution per piece. *See* Chapter VII. *The Postal Service should fully recognize these loss-making products and develop a pricing strategy within the price cap requirements that is designed to increase efficiency and generate adequate revenue.*

In contrast to Mailing Services (market dominant products), volume and revenue increased for Shipping and Package Services (competitive products). Despite rate increases in excess of the CPI, existing Competitive Package Service volume increased 25 percent in FY 2012. During FY 2012, 901 million pieces were transferred from the market dominant product list to the competitive products list. As shown in Table IV-1 revenue for Shipping and Package Services, adjusted for the transfer, increased 8.7 percent, or $926 million. *See* Chapter VIII. *The Postal Service should continue to pursue opportunities to increase volume and generate revenue in this market.*

Operating Expenses

The Postal Service was able to reduce its operating expenses in FY 2012 by 1.1 percent. However, that reduction was not enough to bring operating expenses below revenues. Table IV-3 compares operating expenses for FY 2011 and FY 2012.

Table IV–3—Net Loss—FY 2012 and FY 2011 ($ in Millions)

	FY 2012	FY 2011	Increase (Decrease)	Percent Change
Total Operating Revenue	65,248	65,739	(491)	-0.7%
Compensation & Benefits	47,689	48,310	(621)	-1.3%
Retiree Health Benefit Premiums	2,629	2,441	188	7.7%
Workers' Compensation	1,373	1,290	83	6.4%
Transportation	6,630	6,389	241	3.8%
Other Expenses	9,377	9,994	(617)	-6.2%
Total Operating Expenses	67,698	68,424	(726)	-1.1%
Net Operating Loss	(2,450)	(2,685)	235	
Workers' Compensation Liability Adjustment	2,356	2,382	(26)	
Stautory Retiree Health Benefit Fund Expense	11,100	-	11,100	
Net Loss	(15,906)	(5,067)	(10,839)	

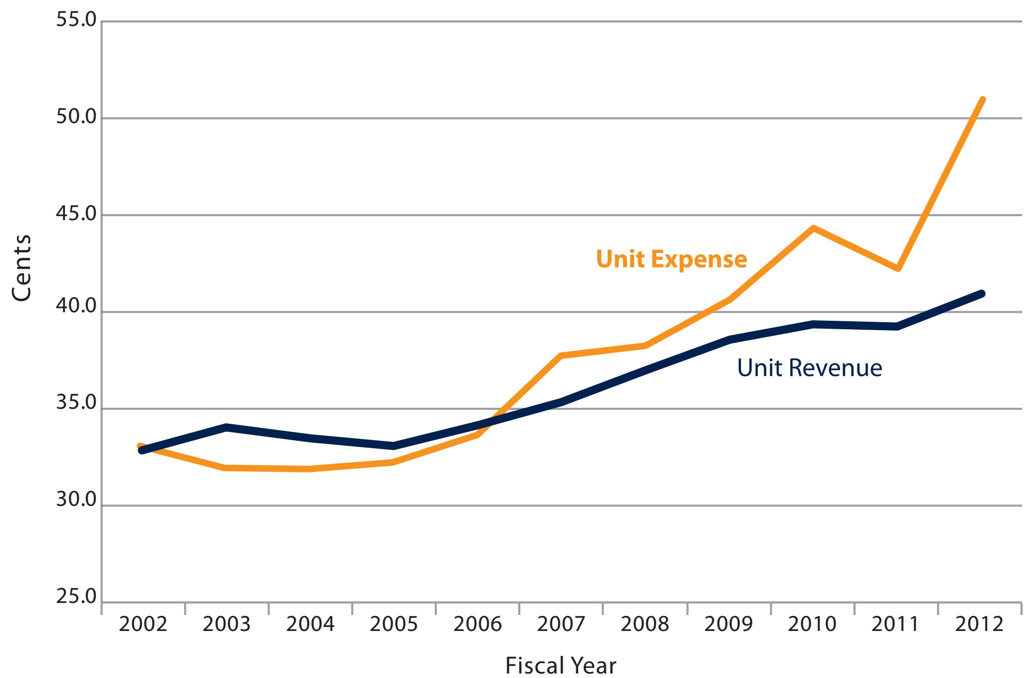
Source: USPS FY 2012 Form 10-K at 31 and 78.

The Postal Service indicates that it should be able to reduce its variable costs by adjusting the related labor costs to match lower volume over a period of several years.[10] It is much more difficult for it to reduce its fixed costs

[10] *Id.* at 35.

which amount to about 40 percent[11] of its total costs. As a result of volume declines, fixed costs are spread over fewer pieces. If the Postal Service is unable to generate revenues that cover total costs, its fixed costs should be addressed in order to remain viable. Figure IV-4 shows that the slow growth in revenue per unit since FY 2007 has not been sufficient to cover steadily escalating unit costs when fixed costs for statutory payments to the RHBF are included. The need to reduce fixed costs has led the Postal Service to adjust service standards, including reducing overnight delivery of First-Class Mail, begin consolidating its processing plants, and consider reducing the frequency of delivery from 6 days to 5 days.

Figure IV–4—Unit Operating Expense and Revenue



Source: PRC-ACR2012-NP-LR1.

The various implications of these service changes have been discussed in two of the Commission's Advisory Opinions: (1) Advisory Opinion on Elimination of Saturday Delivery, Docket N2010-1, March 24, 2011; and (2) Advisory Opinion on Mail Processing Network Rationalization Service Changes, N2012-1, September 28, 2012.

In FY 2012, the Postal Service initiated Mail Processing Network Realignment to address the need to lower fixed costs and increase efficiency.[12] In its Advisory Opinion on Mail Processing Network Realignment and Service Changes, the Commission concluded that it is possible for the Postal Service to undertake significant network rationalization and realize substantial cost savings while preserving most current service levels. *See* Advisory Opinion on Mail Processing Network Rationalization Service Changes, N2012-1, September 28, 2012. The Commission provided recommendations for achieving this goal. The FY 2012 expenses do not reflect the total savings from this initiative.

[11] In FY 2012, fixed costs were 50 percent of total costs due to the deferral of the scheduled FY 2011 RHBF expense of $5.5 billion into FY 2012.
[12] Network realignment projected the closure or consolidation of 140 plants from FY 2012 through FY 2013 and an additional 89 plants in FY 2014.

The results of this initiative, as well as its potential impact on service, will be more apparent in FY 2013.

Financial Reporting Requirements

Section 3654 of title 39 requires the Postal Service to file certain reports with the Commission that conform to the Securities and Exchange Commission (SEC) regulations.[13] The reports to be filed are the annual Form 10-K, the quarterly Form 10-Q, and Form 8-K. Form 10-K is an annual report which contains a comprehensive summary of a company's performance, including the audited financial statements. The report also includes information regarding the executive compensation policies of the company, and detailed information on the compensation and benefits packages of all senior executive officers. This report is due to the Commission within 60 days of the end of the reportable fiscal year. Form 10-K for FY 2012 was filed on November 15, 2012.

Form 10-Q is a similar report to Form 10-K, but filed on a quarterly basis. Form 10-Q provides quarterly financial reports and a management discussion of the Postal Service's operations and finances, including management's assessment of the outlook for the rest of the year. Form 10-Q is required to be filed with the Commission within 40 days of the end of the fiscal quarter. The Postal Service timely filed the required FY 2012 Forms 10-Q in February 2012 (Quarter 1), May 2012 (Quarter 2), and August 2012 (Quarter 3).

Form 8-K is a report that includes major public announcements that could materially affect the financial status of the Postal Service. This includes public releases of financial information within a press release, public speeches, or presentations by operating managers or senior executives to Congress. It includes any updates of significant events that would affect the financial standing of the Postal Service between filings of Form 10-K and/or Form 10-Q, such as resignations, promotions, or retirements of senior executive officers. Form 8-K must be filed within 3 business days of the occurrence of the reportable event.

During FY 2012, the Postal Service filed six Forms 8-K, notifying the Commission of senior executive personnel changes, service standard changes, and publicly reported financial results. All of the Forms 8-K were filed within the 3 day time limit.

The Postal Service has fulfilled its financial reporting obligations under the PAEA by submitting applicable SEC reports to the PRC, thereby providing a measure of financial transparency.

[13] This requirement is also embodied in the Commission's Rules under section 3050.40.

Chapter V

Performance Plans and Program Performance Reports

Introduction

The PAEA requires the Commission to review the performance goals established in the Postal Service's FY 2012 Annual Performance Report (FY 2012 Report) and FY 2013 Annual Performance Plan (FY 2013 Plan).[1] The Commission must evaluate whether the Postal Service has met the performance goals established in the FY 2012 Report, and evaluate the FY 2013 Plan. 39 U.S.C. 3653(d). It may also provide recommendations to the Postal Service related to protecting or promoting public policy objectives in title 39. *Id.*

In the FY 2011 ACD, the Commission found that the quality of information provided in the FY 2011 Annual Performance Report (FY 2011 Report) and FY 2012 Annual Performance Plan (FY 2012 Plan) declined compared to what was provided in the previous year. 2011 ACD at 43. The Commission stated the Postal Service provided fewer details in FY 2011 about the performance goals, performance indicators, and strategic initiatives compared to FY 2010. *Id.* It directed that "[f]uture Annual Performance Reports, Annual Performance Plans, and descriptions of strategic initiatives should, at a minimum, contain information similar in the level of detail provided in the FY 2010 Comprehensive Statement on Postal Operations."[2] FY 2010 Annual Performance Report and FY 2011 Annual Performance Plan. *Id.*

The FY 2012 Report and FY 2013 Plan contain information that was not filed in past years: a new performance goal, 13 new performance indicators, and strategic change initiatives. The Commission notes that the Postal Service incorporated many of the recommendations in the FY 2011 ACD into the FY 2012 Report and FY 2013 Plan. *Overall, the quality of information provided in FY 2012 improved over the information filed in FY 2011. Future Annual Performance Reports and Plans should provide explanations for any deletions.*

The FY 2013 Plan meets most of the statutory requirements listed in 39 U.S.C. 2803. However, as in previous years, the FY 2013 Plan does not "[cover] each program activity set forth in the Postal Service budget…." *See* 39 U.S.C. 2803(a). Also, the FY 2013 Plan did not meet the requirements of sections 2803(a)(2), 2803(a)(5), and 2803(a)(6) with respect to the Corporate Responsibility performance goal. The FY 2012 Report satisfies the requirements in 39 U.S.C. 2804 for each performance goal except for Corporate Responsibility.

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[1] In the FY 2012 ACR, the Postal Service filed as a Library Reference an excerpt from the Postal Service Annual Report containing the FY 2012 Comprehensive Statement, FY 2012 Report, and FY 2013 Plan. Library Reference USPS-FY12-17 (Combined Report).

[2] Docket No. ACR2010, Library Reference USPS-FY10-17, at 51-53 (2010 Comprehensive Statement).

Statutory requirements

Summary of Requirements

In each ACR filing, the Postal Service must submit copies of its most recent Annual Performance Report and Plan. 39 U.S.C. 3652(g). Annual Performance Reports and Plans must meet the requirements set forth in 39 U.S.C. 2803 and 2804.[3] Annual Performance Plans must cover "each program activity set forth in the Postal Service budget...". 39 U.S.C. 2803(a). They must also establish: (1) performance goals expressed in an objective, quantifiable, and measurable form; and (2) performance indicators to measure or assess the relevant outputs, service levels, and outcomes of each program activity.[4]

Annual Performance Reports must set forth the performance indicators established in the Annual Performance Plan, along with the actual performance achieved compared with the performance goals.[5] Annual Performance Reports must include results for the 3 preceding fiscal years. *Id.* 2804(c). Each Annual Performance Report must: (1) review the success of achieving performance goals; (2) evaluate the Annual Performance Plan relative to the performance achieved toward the performance goals; and (3) include summary findings of those program evaluations.[6]

The Commission is required to evaluate annually whether the Postal Service has met the goals established in its Annual Performance Report and Plan. *Id.* 3653(d). It may also "provide recommendations to the Postal Service related to the protection or promotion of public policy objectives set out" in title 39. *Id.*

Compliance with Statutory Requirements

FY 2013 Annual Performance Plan

The FY 2013 Plan meets most of the statutory requirements listed in 39 U.S.C. 2803. However, as in previous years, the FY 2013 Plan does not "[cover] each program activity set forth in the Postal Service budget…".[7] Also, the FY 2013 Plan did not meet the requirements of sections 2803(a)(2), 2803(a)(5), and 2803(a)(6) with respect to the Corporate Responsibility performance goal.

The FY 2013 Plan establishes four performance goals: Provide High-Quality Service, Generate Net Income, Improve Workplace and Workforce, and Corporate Responsibility. Response to CHIR No. 6, question 2. Each performance goal defines the level of performance to be achieved by a program activity. *See* 39 U.S.C. 2803(a)(1). The FY 2012 Plan expresses three of the four performance goals in "objective, quantifiable, and measurable form[s]" as the targets and results set for each performance indicator. *Id.* 2803(a)(2).

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3 Chapter 28 of title 39, which includes sections 2803 and 2804, was added by the Government Performance and Results Act of 1993, Pub. L. No. 103-62, 107 Stat. 285 (1993).

4 *Id.* The Postal Service may express performance goals for a particular program activity in an alternative form if the Postal Service determines that expressing those goals in an objective and quantifiable manner is not feasible. The alternative form must: (1) describe "minimally effective" and "successful" programs; and (2) state why expressing a performance goal in any form for the program activity is infeasible or impractical. *Id.* 2803(b).

5 *Id.* 2804(b)(1). If the Postal Service specifies performance goals in an alternative form by describing minimally effective and successful program activities, it must provide program results relating to those categories. *Id.* 2804(b)(2).

6 *Id.* 2804(d). If a performance goal has not been met, the Postal Service must explain and describe why the goal was not met, as well as plans and schedules for achieving the goal. *Id.* If the performance goal is impractical or infeasible, the Postal Service must explain why that is the case and recommend a course of action. *Id.*

7 *See id.* 2803(a). Program activity means "a specific activity related to the mission of the Postal Service[.]" *Id.* 2801(5).

The Commission finds that the Corporate Responsibility performance goal is not expressed in an "objective, quantifiable, and measureable form[,]" and an alternative form is not used. Thus, the FY 2013 Plan does not meet the requirements of 39 U.S.C. 2803(a)(2) with respect to the Corporate Responsibility performance goal. The Postal Service establishes "Universal and Public Services and Other Obligations" as a performance indicator for the Corporate Responsibility performance goal. However, unlike the other performance indicators, no targets or results are identified.

The FY 2013 Plan "briefly describe[s] the operational processes, skills and technology, and the human, capital, information, or other resources required to meet the performance goals[.]" Response to CHIR No. 6, question 2; *see* 39 U.S.C. 2803(a)(3). It establishes 20 performance indicators used in "measuring or assessing relevant outputs, service levels, and outcomes of each program activity." 39 U.S.C. 2803(a)(4). Ten performance indicators relate to the performance goals, and ten relate to the strategic change initiatives. The FY 2013 Plan also provides "a basis for comparing actual program results with the established performance goals" by comparing FY 2012 results to FY 2012 targets for each performance indicator, except for Universal and Public Services and Other Obligations. *See Id.* 2803(a)(5). Finally, for three of the four performance goals, the FY 2012 Plan describes the objective measurement systems used to verify and validate measured values.[8]

The FY 2012 Plan did not satisfy the requirements of 39 U.S.C. 2803(a)(6) with respect to the Corporate Responsibility performance goal because the Postal Service did not describe the means used to verify and validate measured values for this goal.

FY 2012 Annual Performance Report

The FY 2012 Report satisfies the requirements in 39 U.S.C. 2804 for each performance goal except for Corporate Responsibility. The Postal Service did not include targets or results for the Universal and Public Services and Other Obligations performance indicator, which supports the Corporate Responsibility performance goal.

The Postal Service partially met the performance goals of Provide High-Quality Service and Generate Net Income. In those cases, the Postal Service must explain why it did not meet the performance goal and describe plans and schedules for achieving the performance goal. 39 U.S.C. 2804(d)(3). In response to CHIR No. 6, the Postal Service explained why the performance goals were not met as well as its plans and schedules for achieving the goals. However, it did not provide this information in the FY 2012 Report. *In cases where a performance goal has not been met, Annual Performance Reports should explain why the goal was not met and what action the Postal Service recommends for achieving the performance goal in future years. See Id.*

[8] For Provide High-Quality Service, an outside entity measures First-Class Mail service performance independently and objectively via the External First-Class Mail measurement system. Combined Report at 35. The Postal Service also operates, through a third party, a customer experience measurement survey that provides an ongoing assessment of attributes defined by customers as critical to their experiences. *Id.* at 36. For Generate Net Income, the Postal Service develops financial information according to generally accepted accounting principles and industry best practices. *Id.* Financial systems are subject to review by the Commission, the USPS Office of Inspector General, and the Government Accountability Office. *Id.* For Improve Workplace and Workforce, the Postal Service collects and reports safety data according to standard requirements of OSHA. *Id.* at 37. The Postal Service measures employee engagement using the VOE survey. *Id.* A third-party vendor tabulates the results and reports them back to the Postal Service in summary form. *Id.*

Finally, the FY 2012 Report includes summary findings of program evaluations completed during FY 2011. Table V-1 provides program evaluation measures and metrics. Response to CHIR No. 6, question 6. Additional program evaluation analysis is provided throughout the FY 2012 Report. *Id.*

Table V–1—Comparison of Results with Targets for Performance Goals

Performance Goals	Performance Indicator	2010 Actual	2011 Actual	2012 Target	2012 Actual	2013 Target
Provide High-Quality Service	Single-Piece First-Class Mail Overnight	96.36%	96.23%	96.65%	96.48%	96.70%
	Single-Piece First-Class Mail 2 Days	93.71%	93.34%	94.15%	94.84%	95.10%
	Single-Piece First-Class Mail 3 Days	92.44%	91.87%	92.85%	92.29%	95.00%
	Customer Experience Measurement—Residential	86.44%	87.17%	N/A[1]	88.36%	N/A[1]
	Customer Experience Measurement—Small/Medium Business	81.83%	82.95%	N/A[1]	84.07%	N/A[1]
Generate Net Income	Operating Loss ($ billions)	N/A	(2.7)	(3.0)	(2.5)	(2.1)
	Deliveries per Work Hour	N/A	39.9	42.2	41.0	42.9
Improve Workplace and Workforce	OSHA Illness and Injury Rate	5.49	5.67	5.72	5.44	1% below SPLY
	Voice of the Employee Survey	62.3	64.7	64.9	64.7	TBD
Corporate Responsibility	Universal and Public Services and Other Obligations	N/A	N/A	N/A	N/A	N/A

Note: N/A means not applicable.

Source: Combined Report at 34.

[1] Plan/targets are not set as actual survey response percentages. Internally, as part of the National Performance Assessment, they are computed as an index of survey questions.

Analysis of Performance Goals and Strategic Change Initiatives

The FY 2012 Report and FY 2013 Plan set forth four performance goals: Provide High-Quality Service, Generate Net Income, Improve Workplace and Workforce, and Corporate Responsibility. Response to CHIR No. 6, question 2. To evaluate its progress towards achieving the performance goals, the Postal Service established 10 performance indicators, which are described in more detail below. For 9 of the 10 performance indicators, the Postal Service set annual targets for FY 2013 and published them in the FY 2013 Plan.

The FY 2012 Report provides results against FY 2012 targets and serves as a baseline for establishing FY 2013 targets. Table V-1 lists each performance indicator currently used by the Postal Service to evaluate performance toward achieving its four performance goals.

FY 2012 Changes

In FY 2012, the Postal Service made several changes to its performance goals, performance indicators, and strategic initiatives. In FY 2011, the Postal Service set forth three performance goals: Improve Service, Improve Financial Performance, and Improve Safety and Employee Engagement. 2011 ACD at 45. In FY 2012, the Postal Service renamed these performance goals as Provide High-Quality Service, Generate Net Income, and Improve Workplace and Workforce. Combined Report at 33. It also added Corporate Responsibility as a fourth performance goal. *Id.*

The FY 2012 Report and FY 2013 Plan contain three new performance indicators that support the performance goals. Customer Experience Measurement-Residential and Customer Experience Measurement-Small/Medium Business are two new performance indicators supporting the Provide High-Quality Service performance goal. *Id.* at 34. Universal and Public Services and Other Obligations is a new performance indicator supporting the Corporate Responsibility performance goal, though no targets or results are provided. *Id.* at 33.

The Postal Service also replaced its "strategic initiatives" with "strategic change initiatives" that are designed to close the gap between revenue and cost over the next 5 years. *Id.* at 38. The FY 2012 Report and FY 2013 Plan establish 10 additional performance indicators to evaluate progress towards these strategic change initiatives. *Id.* These performance indicators are discussed below under Strategic Change Initiatives.

Performance Goal 1: Provide High-Quality Service

Postal Service's Filing

The five performance indicators that support Provide High-Quality Service are: Single-Piece First-Class Mail Overnight, Single-Piece First-Class Mail 2 Days, Single-Piece First-Class Mail 3 Days, Customer Experience Measurement—Residential, and Customer Experience Measurement—Small/Medium Business. The Postal Service uses Single-Piece First-Class Mail service performance as a model for service performance reporting and management because it is one of the most widely used mail categories familiar to consumers, small organizations, and larger commercial firms. Combined Report at 35. Single-Piece First-Class Mail uses almost all elements of the Postal Service operating chain, from collection boxes and retail counters to final delivery. *Id.* The Postal Service states that "[Single-Piece First-Class Mail] has been traditionally used to represent service, especially since customers use it and expect bills, statements, payments, business communication and personal correspondence to arrive on time." *Id.*

In FY 2012, the service performance score of 94.84 percent for Single-Piece First-Class Mail 2 Days exceeded the FY 2012 target of 94.15 percent. However, service performance scores for Single-Piece First-Class Mail Overnight and Single-Piece First-Class Mail 3 Days fell slightly below FY 2012 targets. The Postal Service explains that the one contributing factor to missing the targets was the peak season, a time when increased volumes compete for capacity on transportation. Response to CHIR No. 6, question 4. It states that winter weather during the same period made it difficult to achieve service targets in several areas throughout the country. *Id.* The Postal Service notes that it implemented service standard changes and 46 plant consolidations in July 2012 that created variations in processes and networks, which the Postal Service quickly brought under control. *Id.*

In FY 2012, the Postal Service added Customer Experience Measurement—Residential and Customer Experience Measurement—Small/Medium Business as two additional performance indicators under Provide High-Quality Service. Combined Report at 34. The Postal Service explains that it operates, through a third party, the nation's largest customer experience measurement survey. *Id.* at 36. It reports that in FY 2012, response rates were 15.2 percent for residential customers and 8.5 percent for small/medium business customers. *Id.* It notes that the surveys provide an ongoing evaluation of attributes that customers believe are critical to their experiences. *Id.*

In FY 2012, customer experience scores for both Residential and Small/Medium Business improved over FY 2011 scores. *Id.* The Postal Service identified "contact" experience as a key opportunity for improvement. *Id.* In FY 2012, it launched a Customer Experience Essentials program that engaged and provided resources and guidance to all employees who interact with customers. *Id.* The program focuses on four basic principles: telephone courtesy, friendly and courteous behavior, delivery accuracy, and informing customers that their business is appreciated. *Id.*

For a more detailed discussion of Single-Piece First-Class Mail and Customer Experience Measurement performance, please see Chapter VI, *infra*, on Service Performance.

Commission Analysis

The Postal Service partially met the performance goal of Provide High-Quality Service. All three service performance scores for FY 2012 improved over FY 2011 results. FY 2013 targets are also higher than FY 2012 targets. These factors indicate that the Postal Service is meeting its goal of Provide High-Quality Service in some areas.

In the FY 2011 ACD, the Commission recommended that the Postal Service expand the number of performance indicators to include service performance scores for other classes of market dominant mail, including Standard Mail. 2011 ACD at 57. The Postal Service responded that it does measure service performance for all market dominant products, and detailed descriptions of measurement systems and quarterly performance reports are available on the Postal Service website[9] for the following products: Single-Piece First-Class Mail, Presort First-Class Mail, Single-Piece First-Class Mail International, Standard Mail, Periodicals, Package Services, and Special Services. Combined Report at 35. The Postal Service states that the FY 2012 Report and FY 2013 Plan provide a link to publicly-available performance reports for all market dominant products rather than reporting the information twice. Postal Service Reply Comments at 19.

The Commission notes that in addition to providing a link to performance reports for market dominant products, the Postal Service introduced two new performance indicators for the Provide High-Quality Service goal. Nonetheless, the Postal Service's performance goal should reflect its commitment to providing high quality service to all products. *In future years, the Postal Service should include other market dominant products as performance indicators to facilitate comparisons in Annual Performance Reports and Plans.*

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9 *See http://about.usps.com/what-we-are-doing/service-performance/welcome.htm.*

Performance Goal 2: Generate Net Income

Postal Service's Filing

The Postal Service established Operating Loss and Deliveries per Work Hour (DPWH) as performance indicators for the Generate Net Income performance goal. In FY 2012, the Postal Service had a net operating loss of $2.4 billion, which was $0.5 billion lower than the FY 2012 target operating loss of $3 billion. *Id.* at 34. Operating loss excludes the expense impact of Workers' Compensation discount rate changes and actuarial revaluations, as well as the Postal Service RHBF payments. *Id.* at 34 n.3. For FY 2013, the target is a loss of $2.1 billion. *Id.* at 34.

In FY 2012, DPWH of 41 deliveries did not meet the FY 2012 target of 42.2 deliveries.[10] The Postal Service explains that one reason for not achieving the target was that it planned for very aggressive cost reduction plans. Response to CHIR No. 6, question 5. However, the plans changed because network and delivery consolidations took place on a slower schedule than originally planned. *Id.* Also, additional workload was based on higher-than-planned volumes.

In FY 2013, the target DPWH is 42.9. Combined Report at 34. The Postal Service notes that this target is aggressive. Response to CHIR No. 6, question 5. It states that to meet the target, the Postal Service has begun implementing network consolidations, delivery unit consolidations, the POStPlan, and centralized business deliveries. *Id.*

Commission Analysis

The Postal Service partially met its performance goal. The FY 2012 DPWH of 41.0 did not meet the target of 42.2; however, the operating loss was less than in FY 2011. Nevertheless, revenues from FY 2007 to FY 2012 have declined from a high of approximately $75 billion in FY 2007 to approximately $65 billion in FY 2012. The Postal Service recorded a loss of $15.9 billion in FY 2012. For a more detailed discussion of the Postal Service's current financial condition, see Chapter IV on the Postal Service Financial Condition.

In the FY 2011 ACD, the Commission recommended against replacing Total Factor Productivity (TFP) with DPWH as a performance indicator because DPWH does not recognize major workload components, such as collecting, processing, transporting, and sequencing of mail for delivery. 2011 ACD at 57-58. In both the FY 2012 Report and FY 2013 Plan, the Postal Service responds that although TFP is not currently used as a performance indicator, it remains a measure of long-term productivity trends. Combined Report at 36. It states that TFP recognizes both mail volume and delivery points and weights the volume of various postal products to account for variations in work content due to certain factors. *Id.* at 37. These factors include size, weight, mailer preparation levels, and mode of transportation. *Id.* TFP thus allows consistent comparisons among postal products. *Id.* *The Commission recommends that the Postal Service continue to use TFP as a measure of efficiency.*

[10] *Id.* DPWH is an efficiency measure comparing the total number of deliveries of all types with the total number of workhours used in all employee categories. 2011 ACD at 47. The total number of deliveries is calculated by multiplying the number of delivery points by the number of delivery days. *Id.* This number is then divided by the total number of workhours used in all employee categories, including managers and executives. *Id.* The result is the number of annual deliveries completed per workhour used. *Id.*

In the FY 2011 ACD, the Commission also recommended reporting the RHBF obligations and Workers' Compensation Liability Adjustment as part of its operating expenses to include in the financial performance goal. The FY 2012 Report and FY 2013 Plan would have presented more meaningful and useful information if the Postal Service had also reported the RHBF obligations and Workers' Compensation Liability Adjustment as part of its operating expenses.

Performance Goal 3: Improve Workplace and Workforce

Postal Service's Filing

The Postal Service relies on two performance indicators to evaluate progress towards its performance goal of Improve Workplace and Workforce. It uses the Occupational Safety and Health Administration (OSHA) Illness and Injury Rate to measure improvements in safety. The OSHA Illness and Injury Rate is calculated by multiplying the total number of OSHA injuries and illnesses by 200,000 hours, which represents 100 employees working 2,000 hours per year. Combined Report at 34 n. 4. That number is then divided by the number of exposure hours worked by all employees. *Id.*

In FY 2012, the OSHA Illness and Injury Rate of 5.44 was better than the FY 2012 target of 5.72. *Id.* at 34. The target for FY 2013 is 1 percentage point below the 2012 result, which is a slight improvement. *Id.*

The Postal Service tracks employee engagement and workplace concerns using the Voice of the Employee (VOE) Survey, a way for employees to confidentially express their opinions about the work environment. *Id.* at 37. Key questions from the VOE Survey are used to create an index to track progress on employee-centered initiatives and assess national trends. *Id.* The performance indicator is the VOE Survey score, which is the average percent of employees responding favorably to eight questions from the VOE Index. 2011 ACD at 48. These questions address the following issues: Strategic Direction, Trust, Contribution to Postal Service Growth, Communication, Diversity and Respect, Commitment, Personal Safety, and Work Effort and Quality. Combined Report at 37.

In FY 2012, the VOE Survey score of 64.7 did not meet the FY 2012 target of 64.9. Combined Report at 34. The FY 2013 target has not yet been determined.

Commission Analysis

The Postal Service partially met this performance goal. The FY 2012 VOE Survey Score was the same as the FY 2011 score, which demonstrates that the Postal Service is not declining in this area.

The FY 2012 Report and FY 2013 Plan include more information on the VOE Survey Score than the OSHA Illness and Injury Rate. Combined Report at 37. Both the VOE Survey Score and the OSHA Illness and Injury Rate are important performance indicators measuring progress towards the Improve Workplace and Workforce performance goal. *In the FY 2013 Report and FY 2014 Plan, the Commission recommends expanding upon the sections that discuss the OSHA Illness and Injury Rate.*

Performance Goal 4: Corporate Responsibility

Corporate Responsibility is a new performance goal that was introduced in FY 2012. The Postal Service established Universal and Public Services and Other Obligations as a performance indicator supporting this goal. Combined Report at 33. However, it did not provide targets or results for this performance indicator. Because the Postal Service did not include targets and results for its performance indicator it cannot be found to have met its performance goal.

In the FY 2013 ACR, the Corporate Responsibility performance goal should be expressed in an "objective, quantifiable, and measurable form[.]" See 39 U.S.C. 2803(a)(2). The Postal Service may use an alternative form if it determines that expressing the Corporate Responsibility performance goal in an objective, quantifiable, and measurable form is not feasible. *See Id.* 2803(b). The alternative form must describe a minimally effective and successful program and state why it is infeasible or impractical to express the Corporate Responsibility performance goal in any other form. *Id.*

Strategic Change Initiatives

Postal Service's Filing

In FY 2010 and FY 2011, Annual Performance Plans contained nine strategic initiatives to help clarify the connection between performance goals and the actions necessary to achieve them. 2011 ACD at 49. However, the FY 2013 Plan replaced the "strategic initiatives" with "strategic change initiatives" designed to close the gap between revenue and cost over the next 5 years. Combined Report at 38. The Postal Service explains that the portfolio of strategic change initiatives is dynamic and will change as priorities and resources require, and as programs are completed or adjusted. *Id.*

The strategic change initiatives are organized into three categories: Infrastructure and Operations Optimization, Revenue Generation Programs, and Workplace and Workforce Initiatives. Table V-2 displays the FY 2013 strategic change initiatives by category.

Table V–2—FY 2013 Strategic Change Initiatives

Infrastructure and Operations Optimization	Revenue Generation Programs	Workplace and Workforce Initiatives
Mail processing and transportation	Shipping growth	Talent management and development
Delivery	Transaction mail preservation	Employee engagement
Retail access	Marketing mail growth	Dispute resolution
Facilities management and disposal	Global growth	Total labor cost
Financial and information systems	Digital and hybrid mail growth	Workforce optimization
Product visibility	Pricing optimization	
Sustainability	Increasing sales force effectiveness	
Supply chain integration	Customer experience	
Commercial mail acceptance transformation		
Ongoing legislative and regulatory agenda		

Source: Combined Report at 38.

The Postal Service explains that the strategic change initiatives differ from the strategic initiatives established in previous years because they better reflect the Postal Service's current strategic goals. Response to CHIR No. 6, question 7. It contends, however, that the content covered by the strategic change initiatives is substantially similar to the strategic initiatives established in past years. *Id.* Table V-3 lists the FY 2010 and FY 2011 strategic initiatives and the corresponding FY 2012 strategic change initiatives.

Table V–3—Comparison of Strategic Initiatives with Strategic Change Initiatives

FY 2010 and FY 2011 Strategic Initiatives	Correlated FY 2012 Strategic Change Initiatives
1. Intelligent Mail	Infrastructure and Operations Optimization: Product visibility, Commercial mail acceptance transformation
2. Flats Sequencing System	Infrastructure and Operations Optimization: Mail processing and transportation
3. Expand Access	Infrastructure and Operations Optimization: Retail access
4. Optimize Network	Infrastructure and Operations Optimization: Mail processing and transportation, Facilities management and disposal
5. Flexible Workforce	Workplace and Workforce Initiatives: Talent management and development, Employee engagement, Total labor cost, Workforce optimization
6. Reduce Energy Use	Infrastructure and Operations Optimization: Sustainability
7. Reduce Delivery Costs	Infrastructure and Operations Optimization: Delivery
8. Expand Products, Services, and Features	Revenue Generation Programs: Shipping growth, Transaction mail preservation, Marketing mail growth, Global growth, Digital and hybrid mail growth, Customer experience
9. Address Legislative Requirements for Funding	Infrastructure and Operations Optimization: Ongoing legislative and regulatory agenda

Source: Response to CHIR No. 6, question 7.

To measure the performance of the strategic change initiatives, the Postal Service developed 10 cross-portfolio performance indicators. Each performance indicator includes targets and results for FY 2012, as well as the FY 2012 variance. The performance indicators are listed in Table V-4.

The Postal Service states that FY 2013 targets for the cross-portfolio performance indicators are currently being compiled. Response to CHIR No. 6, question 8. It notes that the FY 2013 targets for the cross-portfolio performance indicators may differ from the current FY 2012 targets. *Id.*

Commission Analysis

The strategic initiatives facilitate the Commission's review of performance goals under 39 U.S.C. 3653(d). The Commission reviews the strategic initiatives as part of its evaluation of whether the Postal Service met the performance goals established in the Annual Performance Report and Plan.

Table V–4—Cross-Portfolio Performance Indicators

Description	Planned	Actual	FY 2012 Variance
Total revenue ($)	$935,718,028	$813,556,920	$(122,162,108)
Total cost savings ($)	$581,000,000	$346,338,000	$(234,662,000)
Total work hours reduced (hours)	6,000,000	1,940,200	(4,059,800)
Total headcount reduced (FTEs)	67,080	29,390	(37,690)
Total facility square feet reduced (sq. ft.)	2,200,000	3,308,811	1,108,811
Commercial mail in Full Service (%)	48%	45%	(3%)
IMb adoption rate (%)	80%	81%	1%
Package scanning rate (%)	94%	94%	0%
Overall customer experience score (%)	82%	79%	(3%)
Legislative Impact ($b)	0	0	0

Source: Combined Report at 39.

In the FY 2011 ACD, the Commission directed that the FY 2012 Report and FY 2013 Plan "contain information on strategic initiatives similar in the level of detail to that provided in the FY 2010 Comprehensive Statement." 2011 ACD at 58. The Commission asked the Postal Service to provide the performance indicators used to measure progress in meeting targets. *Id.* It also asked for the FY 2012 targets, FY 2012 results, and FY 2013 targets. *Id.*

As described above, the Postal Service revamped "strategic initiatives" from past years by replacing them with "strategic change initiatives." The Public Representative critiques the Postal Service's presentation of strategic change initiatives. PR Comments at 16. He asserts that it is difficult to determine which performance goals the strategic initiatives relate to because the lists of initiatives are not tied to the performance goals. *Id.* He also argues that the strategic change initiatives lack performance indicators to measure progress towards accomplishing the performance goals. *Id.*

The Postal Service responds that a relationship does exist between the strategic change initiatives and the performance goals. Postal Service Reply Comments at 21. It notes that the inter-related nature of the strategic change initiatives means that more than one initiative may relate to more than one performance goal. *Id.* The Postal Service contends that the Public Representative is improperly imposing the requirements of 39 U.S.C. 2803 and 2804 on the strategic change initiatives, which are not provided as part of the FY 2012 Report and FY 2013 Plan. *Id.* Rather, they are provided as part of a broader strategic plan to achieve these goals. *Id.*

The strategic initiatives were originally designed "to help clarify the connection between performance goals and the actions necessary to achieve them." 2011 ACD at 49. Although they do not directly support the performance goals, they are part of the FY 2012 Report and FY 2013 Plan. The Commission reviews the strategic change initiatives as part of its evaluation of whether the Postal Service met the performance goals established in the Annual Performance Report and Plan. *Id.* at 58.

The Commission finds that the Postal Service has met the requirements of 39 U.S.C. 2803 and 2804 with respect to the strategic change initiatives. The Postal Service established 10 cross-portfolio performance indicators that support the strategic change initiatives. Each performance indicator has FY 2012 targets and results, as well as the FY 2012 variance. FY 2013 targets are currently being compiled. Response to CHIR No. 6, question 8. *To ensure compliance with statutory requirements, the FY 2013 Report and FY 2014 Plan should contain FY 2013 targets, FY 2013 results, and FY 2014 targets for each strategic change initiative performance indicator.*

The Commission finds that the quality of information provided about the strategic change initiatives improved over the FY 2011 Report and FY 2012 Plan. The Commission appreciates that the Postal Service provided a chart linking FY 2010 and FY 2011 strategic initiatives with FY 2012 strategic change initiatives. Response to CHIR No. 6, question 7. *Future Annual Performance Reports and Plans should provide explanations for any deletions.*

Chapter VI

Service Performance

Introduction

39 U.S.C. 3652(a)(2)(B)(i) requires the Postal Service to report on each market dominant product's "level of service (described in terms of speed of delivery and reliability)." The Commission evaluates whether each product meets its standard for level of service. On an annual basis, the Commission compares a product's on-time delivery with delivery goals established by the Postal Service. For Special Services, the Commission evaluates performance data from metrics developed by the Postal Service applicable to each product.

During FY 2012, service performance results for most market dominant products showed improvement toward meeting annual on-time targets. Most First-Class Mail products continued to meet or exceed their annual service performance targets. Special Services products, with the exception of Address Management Services, met or exceeded annual service performance targets. Package Services products, with the exception of Bound Printed Matter Flats, either approached or exceeded annual service performance targets. While most Standard Mail products did not meet or exceed annual on-time targets, service performance improved throughout the fiscal year.

The Postal Service attributes most of these gains to its Work-in-Process diagnostic tools which permit tracking and systemwide troubleshooting using information gathered through Intelligent Mail barcodes (IMb). Library Reference USPS-FY12-29 at 8, 13.

A notable exception to on-time delivery performance improvement has been in Periodicals, which has not met service performance targets. The on-time performance percentage has declined from last year. It is too early to tell if the decline in on-time delivery performance is due to a new, not fully tested measurement system, or an actual decline in service performance.[1]

Many challenges still face the Postal Service in developing reliable measurement systems. For example, the Postal Service systems do not yet provide service reporting by product for large percentages of Standard Mail because of the inability to identify Standard Mail pieces by product. The Postal Service says it is taking steps to address this problem.[2] *The Postal Service is expected to discuss its progress in identifying Standard Mail pieces by product in its next Annual Compliance Report to the Commission.*

1 The Postal Service began measuring Periodicals service performance using the iMAPS system in the first quarter of FY 2012. Library Reference USPS-FY12-29 at 15-16.

2 Response to CHIR No. 5, question 29. Further, the Postal Service will require piece-level detail on its electronic mailing documentation beginning July 2013. DMM Advisory issued November 30, 2012.

Measurement Systems

In FY 2012, the Postal Service used a variety of measurement systems to measure service performance for each market dominant product. Table VI-1 identifies the different systems used to measure service performance for each type of mail reported in the Postal Service's Annual Service Performance Report, filed as Postal Service Library Reference USPS-FY12-29.

Table VI–1 —Market Dominant Service Performance Measurement Systems

	Single-Piece			Presort		
	Letters	Flats	Parcels	Letters	Flats	Parcels
First-Class Mail	EXFC	EXFC	PTS	iMAPS	Proxy (EXFC)	PTS
Periodicals				iMAPS	iMAPS	
Standard Mail				iMAPS	iMAPS	PTS
Package Services			PTS		iMAPS	PTS
International Mail	IMMS	IMMS				
Special Services	Custom designed internally based measurement systems					

Source: USPS. Service Performance Measurement. October 2007 at 6.

External First-Class Measurement System (EXFC)

EXFC is a sampling system managed by an independent contractor, International Business Machines Corporation (IBM). Delivery performance is measured from the street collection box to the delivery mailbox. When evaluating delivery performance, test mailers record the time they place First-Class Mail in the collection box. Those test mailpieces are sent to a nationwide panel of receivers who record when the mailpiece was delivered to their mailbox.[3] Actual transit time is then compared against First-Class Mail service standards. EXFC provides quarterly service performance measurement scores at both the area and district level.

Intelligent Mail Accuracy and Performance Systems (iMAPS)

iMAPS provides an end-to-end service performance measurement by using documented mail arrival time at a designated postal facility to start a measurement clock, and an IMb scan by an external, third-party reporter to stop the clock. The measurement involves two distinct steps. The Postal Service obtains processing times based on IMb scans reported through the Seamless Acceptance and Service Performance (SASP) system. SASP captures data from all Full-Service Intelligent Mail. This is combined with a last mile factor. The last mile factor is developed through scans by third-party reporters upon receipt of the mail. Service performance is measured by comparing the overall transit time to the service standards to determine the percent of mail delivered on time.

3 2009 ACD at 49.

Product Tracking System (PTS)

For use with parcels, PTS is an internal measurement system used by the Postal Service, which measures transit time from the time of mailing until the time of delivery. Measurements are based on Delivery Confirmation scans. Actual transit time is compared against service standards for the market dominant parcel product.

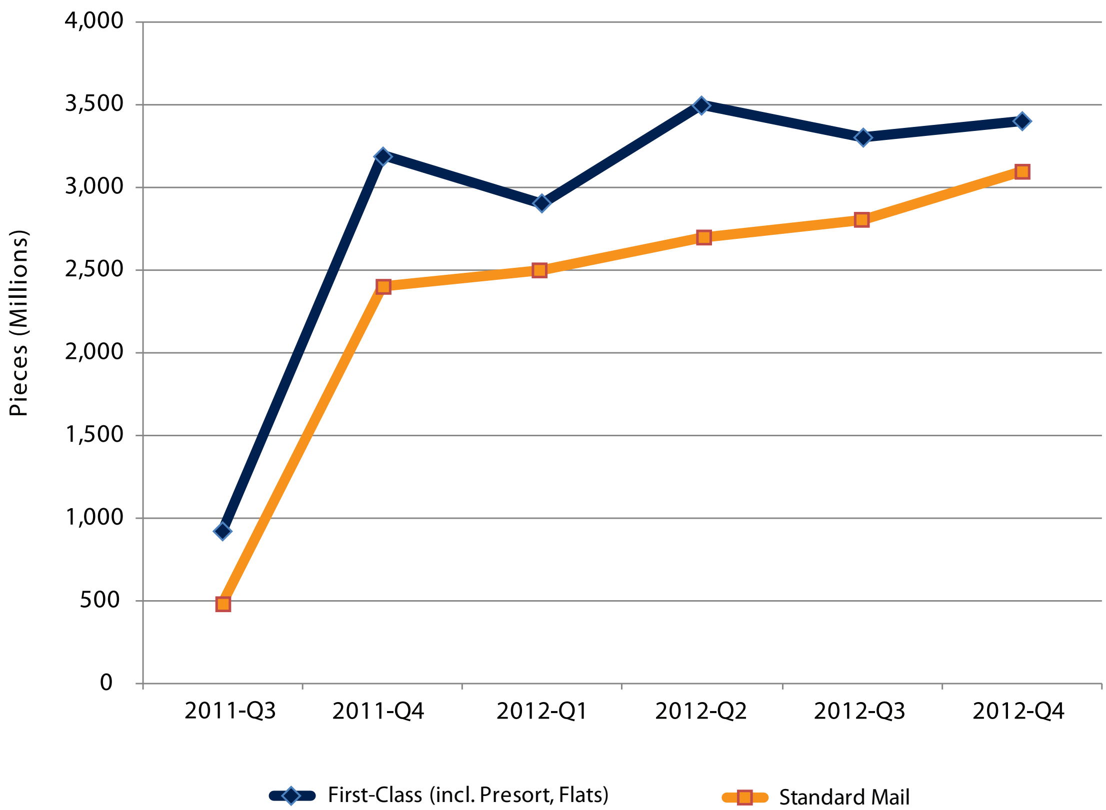
International Mail Measurement System (IMMS)

IMMS measures the domestic leg of transit time for international mail. IMMS is based on a system similar to EXFC. The system measures the time between the domestic collection point and the outbound International Service Center (ISC) for outbound letters and between the inbound ISC and the domestic delivery point for inbound letters.

Intelligent Mail Barcode Developments

The Postal Service expects mailer participation in the Full-Service Intelligent Mail barcode system to continue to increase.[4] The largest increase in Full-Service IMb participation for First-Class Mail and Standard Mail products occurred at the end of FY 2011. Since that time, IMb adoption has slowed. Figure VI-1 shows the increase in the total number of pieces with a Full-Service IMb.

Figure VI–1 — Total Pieces Measured by Intelligent Mail



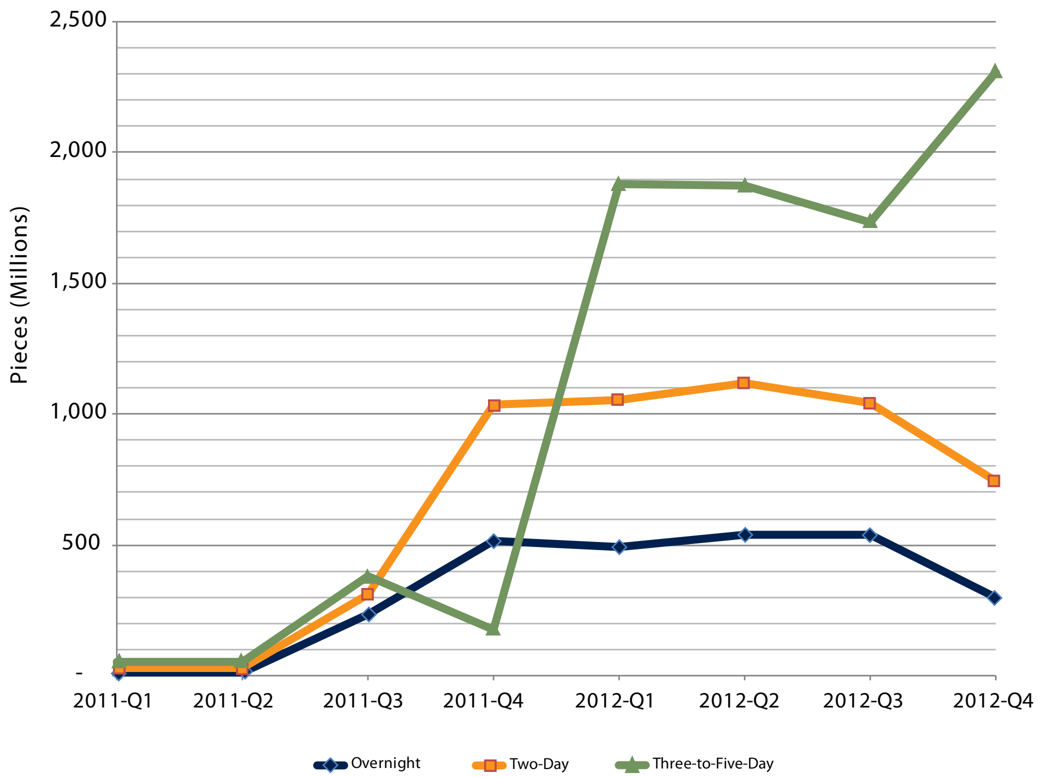
Source: USPS Reports on Full-Service IMb.

[4] Full-Service IMb mailpieces are uniquely identifiable, which permits end-to-end tracking of mailpieces.

In July 2012, new service standards went into effect as a result of the Postal Service's network consolidation initiative that shifted significant volumes from 1 and 2 day service to 3-5 day service. First-Class Mail service performance measurement systems were modified to account for the new service standards. Compilation of data using the new systems began in Quarter 4.

The volume of measurable First-Class Mail within the 3-5 day delivery standard increased almost four-fold since the fourth quarter of FY 2011. According to the Postal Service, the increase in measured mail pieces allows the Postal Service to identify processing bottlenecks, and effectively address regional and district processing issues, thereby increasing general service performance. Figure VI-2 shows the number of Full-Service IMb pieces in measurement by delivery day standard for First-Class Mail Presorted Letters/Postcards.

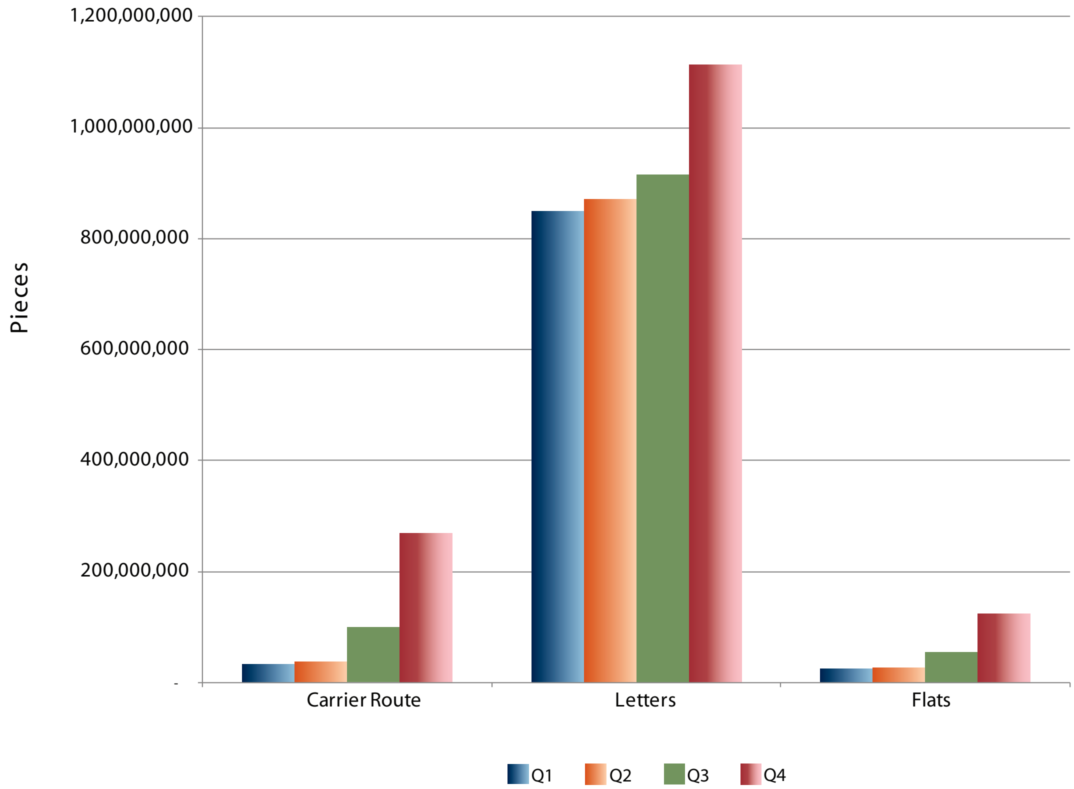
Figure VI–2—First-Class Mail Presorted Letters/Postcards Pieces in Measurement



Source: USPS Quarterly Service Performance Reports.

The volume of Full-Service IMb mail also continues to increase for most Standard Mail products. In FY 2012, the Postal Service saw significant increases in measured mail volume, especially for Letters, Carrier Route, and Flats products. Figure VI-3 shows the percentages of mail volume in measurement for each Standard Mail product by quarter in FY 2012.

Figure VI–3—Measured Mail Pieces - Standard Mail Products



Source: Response to CHIR No. 8, question 13.

The Postal Service has made progress in increasing Full-Service IMb mailer participation. FY 2012 is the first year in which the Postal Service was able to provide product level reporting for most market dominant products based on data obtained from all four quarters of a fiscal year. However, the Commission is concerned about the low level of participation for certain Standard Mail categories, Package Services (especially Bound Printed Matter and Bound Printed Flats) and Periodicals (Within County and Outside County). Low levels of Full-Service IMb adoption cause absences in performance measurement results, or coverage gaps, which then cause unreliable service performance measurements.

First-Class Mail

As seen in Table VI-2, Single-Piece Letters/Postcards and Presorted Letters/Postcards, which comprise more than 94 percent of First-Class Mail, met or exceeded annual on-time service performance targets. Flats, Parcels, Outbound Single-Piece First-Class Mail International, and Inbound Letter Post, which comprise the remainder of First-Class Mail, did not meet annual on-time service performance targets.

Table VI–2—FY 2012 Domestic First-Class Mail Service Performance

First-Class Mail	Target	Percentage On-Time
Single-Piece Letters/Postcards		
Overnight	96.65	97.0
2-Day	94.15	95.6
3-5 Day	92.85	93.2
Presort Letters/Postcards		
Overnight	96.65	96.9
2-Day	94.15	95.9
3-5 Day	92.85	95.4
Flats		
Overnight	96.65	89.8
2-Day	94.15	85.0
3-5 Day	92.85	80.0
Parcels		
Overnight	96.65	89.8
2-Day	94.15	85.8
3-5 Day	92.85	88.4

Source: USPS-FY12-29 at 4.

Single-Piece Letters/Postcards

Service performance for Single-Piece Letters/Postcards is measured using the EXFC system. Single-Piece Letters/Postcards annual performance exceeded the on-time delivery targets for the overnight, 2-day, and 3-5 day mail. The scores surpass FY 2010 and FY 2011 annual results. Service performance for this product has continuously increased each year.

Presorted Letters/Postcards

Service performance for Presorted Letters/Postcards is measured using the iMAPS system. Presorted Letters/Postcards annual performance exceeded the on-time delivery targets for the overnight, 2-day, and 3-5 day mail.

Flats

Service performance for single-piece flats, which comprises 70 percent of First-Class Mail Flats, is measured using the EXFC performance measurement system. The single-piece flats performance score is used as a proxy for presorted flats. FY 2012 is the third consecutive year that the First-Class Mail Flats product has not met on-time delivery service performance targets for overnight, 2-day, or 3-5 day mail.

The Postal Service asserts that quarterly scores showed improvement during FY 2012. It projects continued improvement for subsequent quarters as the Postal Service's Work-In-Process diagnostic tools find and correct the issues contributing to the product performing below targeted service performance. Library Reference USPS-FY12-29 at 8. Table VI-3 shows quarterly performance for FY 2012.

Table VI–3—FY 2012 On-Time Service Performance for First-Class Mail Flats

On-time Service Performance (%)	Quarter 1	Quarter 2	Quarter 3	Quarter 4
Overnight	88.4	90.0	90.9	89.8
2-Day	81.4	84.9	85.9	87.9
3-5 day	74.9	79.5	83.5	81.7

Source: USPS Quarterly Service Performance Report. Quarter 4.

The Postal Service notes that in consultation with the external service performance contractors, it will assess the need for proxy data for presorted flats quarterly and that when sufficient IMb volumes are available, the use of the proxy will be re-evaluated. The Postal Service also mentions its continuing efforts to encourage "the adoption of Full-Service Intelligent Mail service for letters and flats for all mailers, including small volume mailers." Response to CHIR No. 5, question 29.

Parcels

Service performance for Parcels is measured using the Postal Service's internal PTS. Annual performance for First-Class Mail Parcels did not meet on-time service performance targets for overnight, 2-day, or 3-5 day delivery. A review of quarterly scores shown in Table VI-4 shows improvements in service performance for Parcels over the year.

Table VI–4—FY 2012 On-Time Service Performance for First-Class Mail Parcels

On-time Service Performance (%)	Quarter 1	Quarter 2	Quarter 3	Quarter 4
Overnight	86.0	89.7	92.4	92.2
2-Day	78.7	85.7	90.2	91.0
3-5 Day	82.4	88.7	91.7	90.5

Source: USPS Quarterly Service Performance Report. Quarter 4.

Outbound Single-Piece First-Class Mail International and Inbound Letter Post

Service performance for Outbound Single-Piece First-Class Mail International and Inbound Letter Post is measured using the IMMS. Letter-shaped mailpieces are measured using a system similar to EXFC. International flats and parcels are reported using proxies derived from the flats and parcels domestic counterparts. As shown in Table VI-5, Outbound Single-Piece First-Class Mail International and Inbound Letter Post did not meet their annual on-time service performance targets.

Table VI–5—FY 2012 International First-Class Mail Service Performance

First-Class Mail	Target	Percentage On-Time
Outbound Single-Piece First-Class Mail International		
Combined (Overnight, 2-Day, 3-5 Day)	94.0	91.5
Inbound Letter Post		
Combined (Overnight, 2-Day, 3-5 Day)	94.0	90.5

Source: USPS-FY12-29 at 4.

Commission Findings for First-Class Mail

The Commission finds that the Postal Service met its service performance targets for the majority of First-Class Mail products. For First-Class Mail Flats and Parcels the Postal Service did not meets its goals. However, service performance improved during the fiscal year. The Postal Service should plan for corrective action necessary to improve the service performance of both International First-Class Mail products.

Standard Mail

As shown in Table VI-6, two Standard Mail products met or exceeded service targets and four did not.

Table VI–6—On-Time Service Performance for Standard Mail Products

Standard Mail	Target	FY 2011[1]	FY 2012
High Density and Saturation Letters	90.0	86.9	87.2
High Density and Saturation Flats/Parcels	90.0	76.6	90.8
Carrier Route	90.0	50.1	70.6
Letters	90.0	71.3	80.7
Flats	90.0	59.9	70.0
Parcels	90.0	N/A	98.9

[1] The Postal Service began reporting service performance results for Standard Mail in the last quarter of FY 2011

Source: USPS-FY12-29 at 10 and USPS-FY11-29 at 33.

In FY 2012, the Postal Service was unable to evaluate Standard Mail product service performance for a large percentage of letter and flat shaped Standard Mail as required by statute. Fifty-seven percent of measurable Standard Mail letters and 70 percent of Full-Service Intelligent Mail flats were not reportable by product and were reported as "mixed product" categories. Library Reference USPS-FY12-29 at 11.

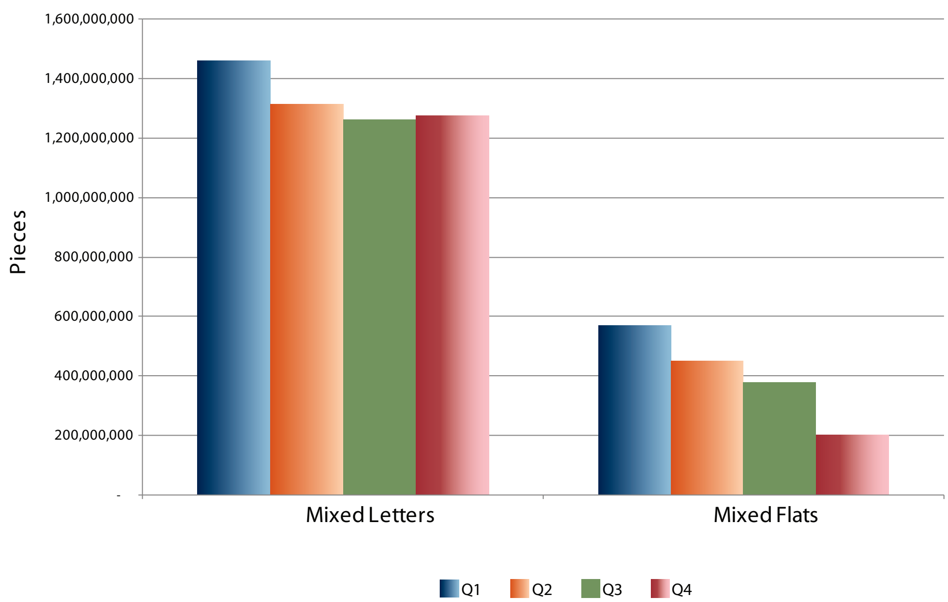
The Postal Service explains that identification of Standard Mail products is based on information supplied by mailers. Mailers are not always required to provide the detailed data that enables service performance reporting at the product level.[5] In such cases, mail cannot be placed into specific product categories and is instead reported as either Mixed Product Standard Letters or Mixed Product Standard Flats.

[5] Notably, the current electronic documentation requirements do not allow mailers using Postal Wizard or the Intelligent Mail Range Record (IMR) type documentation to provide the exact product category for each mail piece. Therefore, the flat-shaped Standard Mail pieces without product category information identified in iMAPS are included in the Mixed Flats group for the performance reporting purposes.

There exists a large volume of Standard Mail categorized as "mixed product flats" or "mixed product letters." Volume that is not identified by product hinders proper service performance measurement for individual Standard Mail products. In addressing this issue, the Postal Service emphasizes its efforts to work with the mailing community to revise mail entry documentation requirements. Response to CHIR No. 5, question 29. Specifically, the Postal Service established a deadline for adopting piece-level documentation, and the current method, which does not require the information, is being eliminated. *Id.*

Figure VI-4 shows the recent decline in Standard Mail Flats not identifiable by product and falling into a mixed category.

Figure VI–4—Measured Mail Pieces—Mixed Product Categories



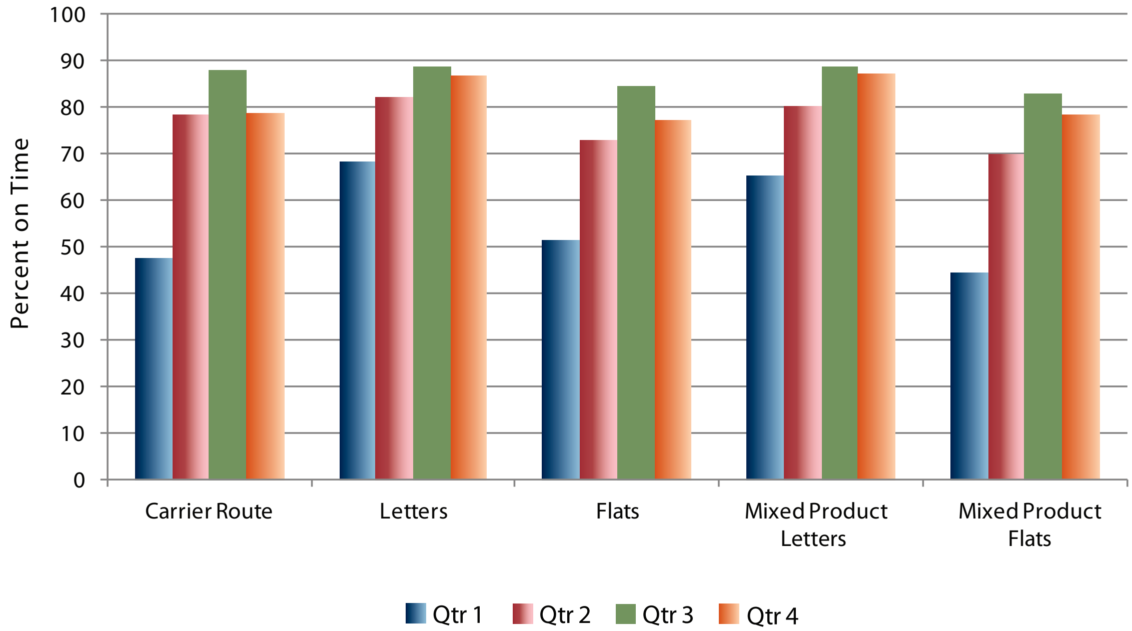
Source: Response to CHIR No. 8, question 13.

Letter and Flat-Shaped Standard Mail Products

Service performance for all letter-shaped, and for non-saturation flat-shaped, Standard Mail is measured using the iMAPS system. FY 2012 was the first year all four quarters of data from the Full-Service Intelligent Mail system were used for service performance measurement. *See* Figure VI-5.

A variation of the iMAPS system is used for measuring destination delivery unit entered saturation flat-shaped Standard Mail. Service performance for this mail is measured by identifying major weekly saturation mailings within the delivery unit to begin measurement. The carrier ends measurement with a scan upon completion of all deliveries on a route. These measurements are compared against the mailer requested in-home window. Library Reference USPS-FY12-29 at 9.

Figure VI–5—FY 2012 Quarterly Service Performance Results



Source: FY 2012 Standard Mail Quarterly Performance Reports.

The Postal Service asserts that performance results in FY 2012 showed steady improvement. It explains that the use of diagnostic tools as well as timely start-the-clock scans will continue to drive the improvement of service performance for the products below target. Library Reference USPS-FY12-29 at 13.

Parcels

Service performance for Parcels is measured using an internal Delivery Confirmation-based system. Table VI-7 shows that the Parcels overall service performance results is based solely on three quarters of data for one metric of Destination Entry 2-day Parcels.

Table VI–7—FY 2012 Available Data for On-Time Service Performance of Standard Mail Parcels

On-time Service Performance (%)	Quarter 1	Quarter 2	Quarter 3	Quarter 4	Annual
Destination Entry 2-Day	N/A	98.9	99.2	99.1	98.9
Destination Entry 3-4 Day					
Destination Entry 5-10 Day					
End-to-End 3-5 Day					
End-to-End 6-10 Day					
End-to-End 11-22 Day					

Source: FY 2012 Quarter 4 Quarterly Performance Reports.

Commission Findings for Standard Mail

The Commission notes the improvements in Standard Mail measurements that have occurred in FY 2012. Over the year, the volume of mail in measurement appears to have increased. However, there are still significant gaps in reporting that need to be filled. This is apparent upon review of the quarterly data which aggregate to the annual service performance reports. Some segments within the Standard Mail products report no data at all.

The large volume of Standard Mail categorized as “mixed product flats” or “mixed product letters” is a continuing concern. The volume within the mixed product categories has been high and has hindered proper service performance measurement for individual products. It is encouraging that measured mix product volumes, especially for mixed product flats, have declined significantly in FY 2012. The effort to properly categorize Standard Mail products should improve the accuracy of service performance measurements.

The majority of Standard Mail did not meet service performance targets in FY 2012. However, service performance improved over the fiscal year. As the Postal Service continues to increase participation in Full-Service IMb and improve identification of mail pieces the Commission expects further improvements in service performance reporting. No further action is required at this time.

Although the reported Parcels performance surpasses the annual service performance goal, the result was based entirely on Destination Entry 2-day Parcels. *The Postal Service must take steps to ensure Parcels reporting is more representative of the entire product.*

Periodicals

Service performance for Periodicals is measured using the iMAPS system. Approximately 12 percent of all Periodicals were included in measurement for FY 2012. 2012 ACR at 14. As shown in Table VI-8, on-time service performance for Within County Periodicals and Outside County Periodicals is significantly below annual service performance goals.

Table VI–8—FY 2012 On-Time Service Performance for Periodical Products

On-Time Service Performance (%)	FY2012 Annual	Target
Outside County	68.7	91.0
Within County	68.7	91.0

Source: USPS-FY12-29 at 14.

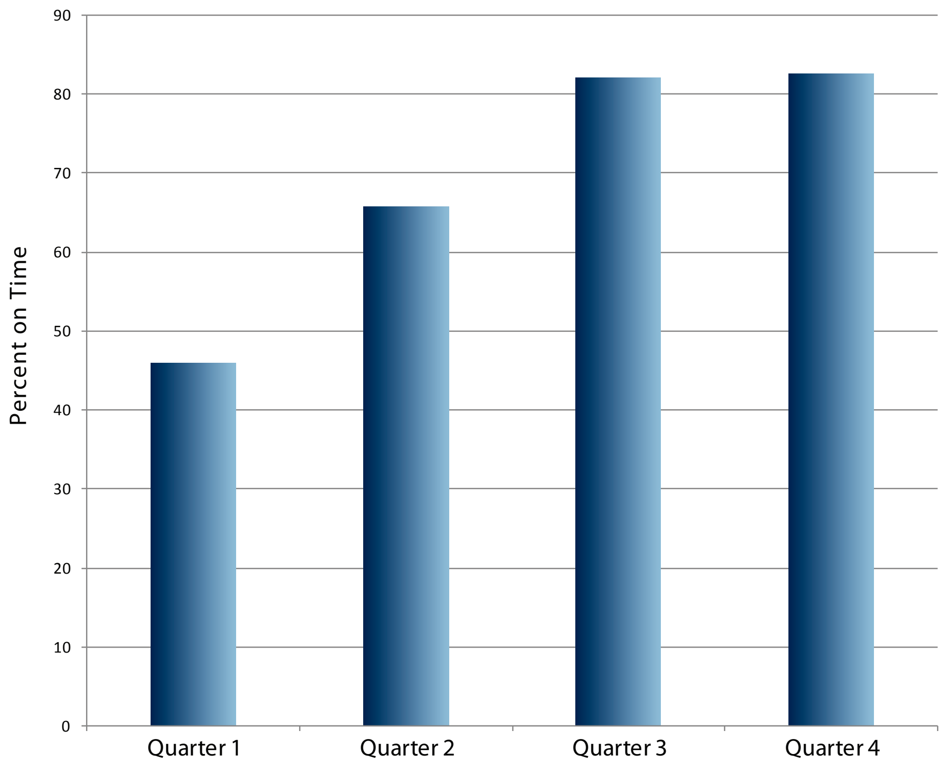
An all Periodicals measurement is used as a proxy for both the Within County Periodicals and Outside County Periodicals product measurements. The Postal Service explains that data are currently not available to identify significant portions of Periodicals by product. Furthermore, the small size of Within County Periodicals mailers makes it less likely that they will make the transition to barcoding or mail preparation systems that allow individual product identification.[6]

[6] Response to CHIR No. 9, question 28, Library Reference USPS-FY12-29 at 14-15.

In the first quarter of FY 2012, the Postal Service transitioned away from using the previous measurement systems based on Red Tag and Del-Trak.[7] As a consequence, carrier route bundles which bypass automation may not be measured.[8]

As shown in Figure VI-6, on-time service performance improved from quarter 1 to quarter 4 of FY 2012.

Figure VI–6—Quarterly Periodicals Service Performance



Source: USPS Quarterly Service Performance Reports.

Commission Findings for Periodicals

Neither Periodicals product met its service target for FY 2012. However, service performance improved throughout the fiscal year. The *Periodicals Mail Study, Joint Report of the United States Postal Service and Postal Regulatory Commission*, released in September 2011, identified several operational changes designed to increase efficiency. The Postal Service implemented many of these recommended changes in FY 2012. As these changes take effect and the Postal Service continues to use its diagnostic tool to identify service issues, service performance should improve further in FY 2013.

7 Library Reference USPS-FY12-29 at 15. The Red Tag Monitoring Service is operated by the not-for-profit Red Tag News Publication Association to monitor service for association members. The Del-Trak System is operated by Time, Inc. to monitor service for several of its publications. Service is measured end-to-end using mailer-reported entry times to start-the-clock and external reporter delivery dates to stop-the-clock. The transit time for each of the tested publications is compared against the service standards for Periodicals. Data from the two external systems are reviewed, combined and weighted by an independent contractor.

8 Library Reference USPS-FY12-29 at 15-16.

Package Services

The Bound Printed Matter Parcels and Media Mail/Library Mail products within Package Services met or exceeded annual on-time service performance targets. Single-Piece Parcel Post,[9] Bound Printed Matter Flats, and Inbound Surface Parcel Posts (at UPU rates) products within Package Services did not. Package Services is comprised mostly of parcels, but also includes some catalogs and other bound printed items too heavy to be sent as Standard Mail. As shown in Table VI-9, service performance for all products improved in FY 2012.

Table VI–9—On-Time Service Performance for Package Services Products

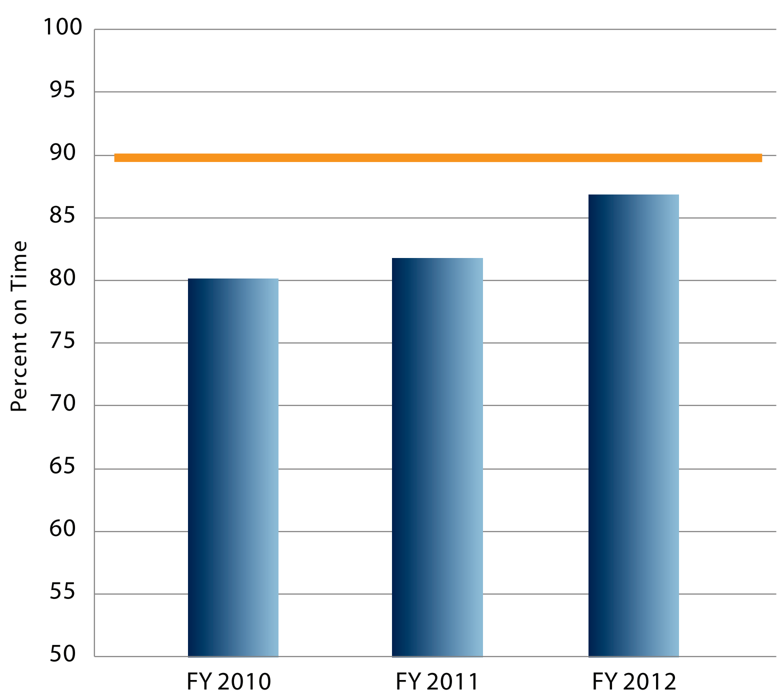
On-time Service Performance (%)	FY 2011	FY 2012	Target
Single-Piece Parcel Post	81.8	86.8	90.0
Bound Printed Matter Flats	42.1	54.3	90.0
Bound Printed Matter Parcels	83.2	94.4	90.0
Media Mail/Library Mail	87.5	92.7	90.0
Inbound Surface Parcel Post (at UPU rates)	81.8	86.8	90.0

Source: USPS-FY12-29 at 19 and USPS-FY11-29 at 23.

Single-Piece Parcel Post (Alaska Bypass Service)

Service performance for Single-Piece Parcel Post is measured using the internal PTS system, which is based on Delivery Confirmation scans. Figure VI-7 compares service performance from FY 2010 through FY 2012.

Figure VI–7—Single-Piece Parcel Post Annual Comparison



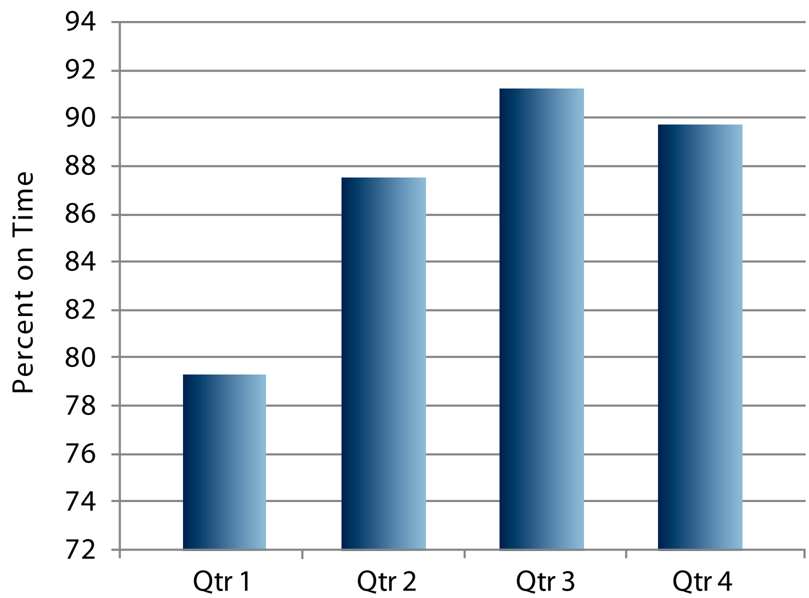
Source: USPS-FY10-29, USPS-FY11-29, and USPS-FY12-29.

[9] Single-Piece Parcel Post has been re-classified as a competitive product. The remaining volume in the market dominant category is now called Alaska Bypass Service.

Inbound Surface Parcel Post (at UPU rates)

Inbound Surface Parcel Post (at UPU rates) consists of items weighing up to 70 pounds originating in other countries and transported to the United States. Only the domestic leg of this international product is evaluated. Service Performance is estimated using Single-Piece Parcel Post service performance as a proxy. In FY 2012, Single-Piece Parcel Post was transferred to the competitive product list where service performance measurement is not required. Consequently, this proxy will no longer be valid in FY 2013. This product did not meet its service performance target in FY 2012. As seen in Figure VI-8 service performance improved throughout the year.

Figure VI–8—FY 2012 Inbound Surface Parcel Post (at UPU rates) Quarterly Service Performance



Source: FY 2012 Package Services Quarterly Performance Reports.

Bound Printed Matter Flats

Service performance for Bound Printed Matter Flats is measured using the iMAPS system. Neither the Destination Entry nor the end-to-end components of this product met the on-time service performance goal for FY 2012. For the end-to-end component, Table VI-10 shows the Postal Service reported only first quarter results.[10]

Table VI–10—FY 2012 On-Time Service Performance for Destination Entry and End-to-End Components of Bound Printed Matter Flats

On-time Service Performance (%)	Quarter 1	Quarter 2	Quarter 3	Quarter 4	FY 2012 Annual	Target
Destination Entry	41.7	60.7	49.2	67.2	55.2	90.0
End-to-End	24.1				24.1	90.0

Source: USPS Quarterly Service Performance Report. Quarter 4.

[10] Quarterly Service Performance Report, FY 2012, Quarter 4, Issued February 8, 2013.

Bound Printed Matter Parcels

Bound Printed Matter Parcels is a commercial product used by businesses to send books, directories, or large catalogs too heavy or rigid to qualify as Bound Printed Matter Flats. Service performance for Bound Printed Matter Parcels is measured using the Postal Service's internal PTS system. In FY 2012, Bound Printed Matter Parcels exceeded the annual target of 90 percent on-time delivery.

Media Mail/Library Mail

Media Mail/Library Mail is a content restricted product. By law, its content is restricted to books, noncommercial films, computer-readable media, and similar items that typically have educational, cultural, scientific or informational value. The product is used by businesses and by the general public to send books and eligible media or other permitted items either for business, personal, educational, or literary purposes.[11] Service performance for Media Mail/Library Mail is measured using the Postal Service's PTS system. On-time service performance for Media Mail and Library Mail was 92.7 percent in FY 2012, which exceeded the annual target.

Commission Findings for Package Services

Single-Piece Parcel Post did not meet on-time service performance goals in FY 2012, however, it has shown steady improvement over the years. The majority of this product was transferred to the competitive product list in FY 2012.

The Commission is concerned that the performance measurement and results for Bound Printed Matter Flats are not improving. Results remain far from the annual target, and limited volume in measurement continues to hinder end-to-end measurement. *The Postal Service should work with mailers to increase measured volume and utilize diagnostics to increase performance results.*

With Alaska Bypass Service replacing Single-Piece Parcel Post on the market dominant product list, the Postal Service must propose use of an appropriate measurement system on proxy for Inbound Surface Parcel Post (at UPU rates) for service performance measurement in FY 2013.

Special Services

In FY 2012, all but one special service met or exceeded the annual service performance targets.[12] Address List Services, which measures the number of days between a customer's request for address list service and transmission of the corrected address information to the customer, did not meet its annual target. The Postal Services explains that "the failure to meet the target was due to a delay in processing by the responsible Address Management System field offices."[13] Table VI-11 illustrates that most results in FY 2012 remained above annual targets.

11 Quarterly Service Performance Report, FY 2012, Quarter 1, February 16, 2012.

12 Library Reference USPS-FY12-29 identifies the Special Service's where the Postal Service provides service performance reporting (at 21-3), and the Special Service's that have been granted a semi-permanent exception from reporting (at 25-6).

13 The Postal Services implemented retraining efforts to communicate the importance of timely entry of information into the tracking system. 2012 ACR at 26.

Table VI–11—On-Time Service Performance for Special Services Products

Special Services	Target	FY 2010	FY 2011	FY 2012
Ancillary Services	90.0	93.0	93.4	93.4
International Ancillary Services	90.0	99.2	99.6	99.6
Address Management Services	90.0	100.0	93.3	83.3
Confirm	90.0	99.6	99.7	98.8
International Business Reply Mail Service	—	—	—	NR[1]
Money Orders	90.0	95.4	97.2	99.2
Post Office Box Service	90.0	94.3	93.1	92.6
Stamp Fulfillment Services	—	N/A[2]	N/A[2]	96.7

[1] NR indicates not reported.
[2] N/A indicates measurement results were not yet available.

Source: USPS-FY12-29 at 23 and 2011 ACD at 79.

Participant Comments

National Postal Policy Council (NPPC) contends that the service performance report does not clearly illuminate whether service quality has improved or whether the apparent improvement in service quality is reflective of changes to service standards due to the first phase of the Postal Service's network realignment. Furthermore, NPPC does not agree with the Postal Service's contention that customers care more about consistency of service than speed. NPPC members care both about consistency and speed of delivery. Finally, NPPC suggests that the Commission address the implications of reduced service standards on the price cap for First-Class Mail. NPPC Comments at 11-13.

The Public Representative attributes improvements in service performance scores to the relaxation of delivery standards due to network realignment and to the Postal Service's use of new service performance diagnostic tools. The Public Representative suggests that the Commission inquire into the omission of end-to-end Bound Printed Matter data after the first quarter of FY 2012. Public Representative Comments at 20-25.

Valpak contends the Commission should be determining service performance compliance with respect to both speed of delivery and reliability. However, Valpak notes the absence of reporting reliability and states this is surprising since the Postal Service contends that users of First-Class Mail consider reliability to be more important than speed. *See* Docket No. 2012-1, USPS-SRT-4 at 6-7. Valpak suggests potential improvements in service performance reporting, such as the Postal Service reporting comparable speed of delivery data from prior years, to provide a ready comparison of service performance trends. Valpak also suggests reporting the average days to delivery and the percentage of late mail.

Finally, Valpak comments on the large percentage of Standard Mail that is reported in a mixed category and not by individual products as required by statute. Valpak contends that this limits the available performance data for individual products within Standard Mail. Valpak Direct Marketing Systems, Inc. and Valpak Dealers' Association, Inc. Reply Comments on the United States Postal Service FY 2012 Annual Compliance Report at 44-53.

Commission Analysis

The Commission will monitor the effects of the Postal Service's network realignment on service performance. However, data at this time are too limited to draw any meaningful conclusions.

Whether customers place more emphasis on speed of delivery or reliability of service varies depending on their needs. At this time, service performance measurements annually report the percentage of on-time delivery. On-time delivery is informative as to both speed of delivery and reliability of service, with greater emphasis on speed of delivery. *The Postal Service could increase emphasis on reliability of service by reporting tail-of-the-mail, the percentage of mail being delivered 1, 2, or 3 days late, in its annual report to the Commission.*

Customer Access

Introduction

The Postal Service reports on customer access to market dominant postal services both to provide insight into customer satisfaction and because of the effect customer access has on the level of service provided. *See* 39 U.S.C. 3652(a)(2). The Postal Service provides information on the number and type of post offices, including suspended post offices, the number of residential and business delivery points, and the number of collection boxes. A customer's average wait time in line is provided to evaluate the time a customer must wait to receive retail services. Additionally, the Postal Service supplements its reporting with information on alternative access channels.

Maintaining adequate customer access is important notwithstanding volume declines and changes in mailer behavior.[14] Over the years, the Postal Service has reduced its retail network by removing collection boxes and other collection points, and either closing postal retail facilities or reducing hours of operation. Access to postal services, however, is being supplemented with the addition of alternative marketing channels.

Retail Facilities

Table VI-12 provides the number of operational retail postal facilities by type for FY 2010 through FY 2012. The aggregate number of Postal Service retail facilities closed in FY 2012 is less than in FY 2011. Closings of Classified Stations, Branches and Annexes decreased but the number of Post Office closings increased.

Table VI–12—Postal Service Operational Retail Facilities

Factility Type	FY 2012	FY 2011	FY 2010	FY 2012 Change from FY 2011	FY 2011 Change from FY 2010
Post Offices	26,755	26,927	27,077	(172)	(150)
Clasified Stations & Branches and Carrier Annexes	5,102	5,219	5,451	(117)	(232)
Total Facilities	31,857	32,146	32,528	(289)	(382)

Note: Does not Include Offices Under Suspension.
Source: USPS 2012 Annual Report to Congress, at 23.

[14] One of the Postal Service's FY 2011 strategic initiatives was to expand postal access by means other than a postal retail facility.

On May 25, 2012, the Postal Service requested an Advisory Opinion from the Commission on POStPlan, a proposal to realign the hours of operation at approximately 17,700 of its more than 32,000 postal retail locations to more closely reflect workload at these offices.[15] Under POStPlan, the Postal Service reviewed the workload at EAS Level 16[16] and lower post offices to determine whether: (1) the office will be upgraded to EAS Level 18 or above; (2) window hours will be realigned to reflect actual workload; or (3) the post office will undergo a discontinuance study.[17] The Commission issued its Advisory Opinion on the POStPlan on August 23, 2012. In summary, the Commission found that the POStPlan's objective of achieving cost savings with limited reductions in access and service is consistent with public policy. It concluded that if implemented properly, the POStPlan should help balance service and cost savings in a manner consistent with the law. To further enhance the implementation of the POStPlan, the Commission's Advisory Opinion provided recommendations concerning access, community input, revenue, and staffing.

During hearings held on the proposal, the Postal Service testified that post offices will continue to provide the same services they provide today. Specifically, access to post office boxes will remain unchanged, collection boxes at post offices will remain in place, and Saturday hours will not be affected.

As a result of POStPlan, the hours of operation at nearly 13,000 post offices nationwide are being reduced to 6, 4, or 2 hours per weekday. In a few locations, hours of operation will increase. Table VI-13 shows the number of offices subject to POStPlan. Although POStPlan may reduce retail service and customer convenience at certain post offices by reducing weekday hours of operation, the Postal Service plans to maintain access to postal services in the following ways:

- Post offices will continue to provide the same services they provide today;
- Access to post office boxes will remain unchanged;
- Collection boxes at post offices will remain in place;
- Saturday hours will not be affected; and
- Post offices in the most remote and isolated locations will remain open at least 6 hours each weekday.

Table VI–13—Change in Hours of Operation Under POStPlan

	Number of Offices	Percent of Total
Increase	73	0.4%
No Change	4,752	27.0%
Decrease	12,801	72.6%
Total	17,626	100.0%

Source: Docket No. N2012-2, Library Reference USPS-LR-N2012-2/1.

15 Docket No. N2012-2, United States Postal Service Request for an Advisory Opinion on Changes in the Nature of Postal Services, May 25, 2012, at 1 (Request).

16 Post Offices are categorized by an EAS designation. The EAS designation reflects the Executive and Administrative Pay Schedule of the Postmaster assigned to the post office.

17 Request at 2.

Post Office Suspensions

Postal Service data shown in Table VI-14 indicate that 211 offices were under suspension at the end of FY 2012. Twenty-two offices which had been under suspension were subsequently reopened.

Table VI–14—Number and Discontinuance Status of Suspended Offices

Time Period	Reopened	Not in Discontinuance Process	In Discontinuance Process – Pre-Final Determination	Final Determination Issue	Subtotal	Total
Under Suspension Prior to FY 2012	1	47	34	5	86	87
Suspended in FY 2012	21	9	91	25	125	146
Under Suspension EOY FY 2012	22	56	125	30	211	233

Source: USPS-FY12-46.

The Commission has expressed concern about the duration of time offices remain under suspension without being reopened or being formally discontinued.[18] Table VI-14 indicates that over 90 percent of the offices suspended in FY 2012 are involved in the discontinuance process. This is in contrast with offices under suspension prior to FY 2012 where only 45 percent were involved in the discontinuance process. The Postal Service's recently revised discontinuance procedures and the advent of the POStPlan with its emphasis on keeping offices open with reduced operating hours may impact the number of extended suspensions.

Table VI-15 shows a breakdown of the 211 offices under suspension by the cause of the suspension. Postal Service Handbook PO-101 specifies certain circumstances that may justify a suspension as including, but not limited to:

- A natural disaster;
- Termination of a lease or rental agreement when suitable alternate quarters are not available in the community, especially when the termination is sudden or unexpected;
- Lack of qualified personnel to run the office;
- Irreparable damage when no suitable alternate quarters are available in the community;
- Severe damage to, or destruction of, the office;
- Challenge to the sanctity of the mail; and
- Lack of adequate measures to safeguard the office or its revenues.[19]

As shown in Table VI-15, the leading cause of suspensions is lease terminations which account for 44 percent of the total. Lack of qualified personnel is the second leading cause at 22 percent.

Table VI-16 shows the number of offices under suspension by date of suspension. There are offices which have been under suspension since 1984, and more than 25 percent of the total number of offices under suspension at the end of FY 2012 have been suspended for more than 2 years. When a post office has been suspended for such an extended period of time, it could be seen as a de facto closing that did not provide for the required community notices.

[18] *See* Docket No. PI2010-1, Investigation of Suspended Post Offices.

[19] USPS Handbook PO-101, January 2012.

Table VI–15—Number of Offices Under Suspension

Suspension Reason	Number of Offices	Percentage of Total
Lease Expiration/Termination	92	43.6%
Lack of Qualified Personnel	47	22.3%
Health/Safety	41	19.4%
Natural Disasters	12	5.7%
Other	7	3.3%
No Data	12	5.7%
Grand Total	**211**	**100.0%**

Source: USPS-FY12-46.

Table VI–16—Number of Suspended Offices by Fiscal Year

FY of Suspension	Number of Offices Suspended
1984	1
1986	1
1988	2
1991	1
1992	1
1994	1
1999	1
2001	2
2002	2
2003	3
2004	3
2005	2
2006	2
2007	5
2008	3
2009	13
2010	14
2011	30
2012	124
Grand Total	**211**

Source: Response to CHIR No. 2, question 1, USPS-FY12-38.

Delivery Points

Table VI-17 provides the number of residential and business delivery points by delivery type for FY 2009 through FY 2012. The change in the number of delivery points in FY 2010, FY 2011, and FY 2012 is also shown. The total number of delivery points continues to grow, increasing by 654,560 from FY 2011 to FY 2012. The growth in delivery points in FY 2012 is the result of an increase in residential delivery points. While business delivery points continued to decrease, the rate of decrease was lower in FY 2012 than in FY 2011. Table VI-18 shows the average number of pieces delivered per delivery point. For FY 2012, the average pieces per delivery point is 1,051. In FY 2000, the Postal Service reported there were on average 1,529 pieces per delivery point.[20]

Table VI–17—Postal Service Delivery Point Statistics

Delivery Points	FY 2012	FY 2011	FY 2012 Difference from FY 2011	FY 2010	FY 2011 Change from FY 2010	FY 2009	FY 2010 Change from FY 2009
Residential Delivery Points							
City Delivery	81,040,591	80,792,112	248,479	80,531,231	260,881	80,187,505	343,726
Rural	39,449,400	39,067,740	381,660	38,638,280	429,460	38,264,946	373,334
PO Box	15,994,508	15,891,349	103,159	15,739,698	151,651	15,601,883	137,815
Highway Contract	2,678,508	2,639,061	39,447	2,607,138	31,923	2,576,166	30,972
Total Residential Delivery	**139,163,007**	**138,390,262**	**772,745**	**137,516,347**	**873,915**	136,630,500	**885,847**
Business Delivery Points							
City Delivery	7,525,979	7,487,332	38,647	7,457,500	29,832	7,483,461	(25,961)
Rural	1,493,644	1,468,861	24,783	1,453,292	15,569	1,439,266	14,026
PO Box	3,889,964	4,072,664	(182,700)	4,355,674	(283,010)	4,489,688	(134,014)
Highway Contract	73,957	72,872	1,085	72,648	224	72,966	(318)
Total Business Delivery	**12,983,544**	**13,101,729**	**(118,185)**	**13,339,114**	**(237,385)**	**13,485,381**	**(146,267)**
Total Delivery Points	152,146,551	151,491,991	654,560	150,855,461	636,530	150,115,881	739,580

Source: USPS 2012 Annual Report to Congress at 23.

Table VI–18—Annual Pieces Per Delivery Point

	FY 2012	FY 2011	FY 2010	FY 2009
No. of Pieces (Millions)	159,859	168,297	170,859	176,744
Pieces/Delivery Point	1,051	1,111	1,133	1,177

Source: USPS 2012 Annual Report to Congress at 23.

20 USPS Annual Report to Congress, 2001 at 46-47.

Wait Time in Line

Tables VI-19, VI-20, and VI-21 illustrate wait time in line experiences at postal retail facilities. To provide insight into customer experiences at its retail outlets, the Postal Service, through the Retail Customer Experience (RCE) program, hires private "mystery shoppers" who test customer experiences at approximately 8,400 of its larger retail outlets. Table VI-21 shows the average wait time in line by administrative area for FY 2011 and FY 2012 and by fiscal quarter for FY 2012. Wait time in line decreased in FY 2012 for every administrative area except the Pacific area where it increased by less than 9 seconds.

The Postal Service also uses its Customer Experience Measurement (CEM) survey to gauge customer perception of wait time in line. Customer average wait time in line based on the CEM survey question is shown in Table VI-19. Wait time in line is broken down by small/medium Business customers and Residential customers for FY 2010 through FY 2012.

Table VI–19—Average Wait Time in Line

	Small/Medium Business			Residential		
Wait Time In Line	FY 2012	FY 2011	FY 2010	FY 2012	FY 2011	FY 2010
Less than 1 minute	18%	18%	17%	19%	19%	18%
1-3 minutes	31%	29%	28%	32%	31%	29%
4-5 minutes	23%	23%	23%	24%	24%	23%
Subtotal 5 minutes or less	72%	70%	68%	75%	73%	70%
6–10 minutes	16%	17%	17%	15%	15%	16%
11–15 minutes	7%	7%	8%	6%	6%	7%
16 minutes or more	5%	6%	7%	5%	5%	7%
Total	100%	100%	100%	100%	100%	100%

Source: USPS-FY12-38, USPS-FY11-38 and USPS-FY10-38.

One measure derived in part from mystery shoppers is a wait time in line score combined with a service standard of "Five Minutes or Less." The goal for FY 2012 for wait time in line was 88 percent of customers waiting 5 minutes or less.[21] The Postal Service reports that final results for FY 2012 produced a national wait time in line score of 88 percent, which meets the target and reflects an improvement over the prior year by 1.1 percentage points. The FY 2012 goal for the overall retail experience of 92.7, was exceeded by 0.1 percentage points. Table VI-20 shows the "Overall Retail Experience" goals and actual for FY 2012.

The Public Representative questions the large discrepancy between wait time in line presented by the Postal Service in its ACR, and wait time in line calculated in Library Reference USPS-FY12-38. Public Representative Comments at 58-60; Public Representative Reply Comments at 34-5. He calculates an average wait time in line of 3.9 minutes compared to the Postal Service's 2 minutes 34 seconds. The Public Representative offers suggestions to improve wait time in line reporting by the inclusion of additional questions in the CEM survey. Public Representative Comments at 60.

[21] *Id.*

Table VI–20—Overall Retail Experience

	FY 2012 Goal	FY 2012 Actual
Overall Retail Experience[1]	92.7	92.8
Wait Time in Line (Pct. Waiting 5 min or less)	88.0%	88.0%

[1] Overall Retail Experience Score is calculated from mystery shopper results: 40 percent (wait time in line score) + 15 percent (HAZMAT score) + 20 percent (image score) +25 percent (promotion and merchandizing score)

Source: USPS 2012 Annual Report to Congress at 47.

The Postal Service explains that wait time in line data are obtained from the mystery shopper program, and not the CEM survey.[22] It explains that CEM separately asks questions about customers' impressions of their visits, but this information is not used in calculating wait time in line. The Postal Service states that the cost of the survey would increase as suggested by the Public Representative, and response rates would decrease. Reply Comments of the United States Postal Service at 22-23.

The Commission accepts the Postal Service's approach to measuring wait time in line. Obtaining data from the mystery shopper program provides a measured time. Data from the CEM survey provides a customer's impression of service, which is also useful.

Collection Points

Collection points are an important access channel for single-piece First-Class Mail. Collection points are defined locations where a customer drops off mail for collection by the Postal Service. These can include collection boxes, mailchutes, firm pickups, Automated Postal Center (APC) drops, lobby drops, and mail collection racks. All collection points are required to be entered in the Collection Point Management System (CPMS) by the responsible district. Data contained in the CPMS database include collection point address, location-type (*i.e.*, Business, Residential, Post Office Lobby, etc.), box type (standard, jumbo, snorkel, etc.), days of the week the point is accessed and the times (including the final collection time) it is accessed.

Table VI-22 shows the number of collection points by location-type, and separately in Table VI-23, the percent of total collection points for the three most numerous locations, business districts, residential areas and at post offices. The rate of decline in collection points slowed in FY 2012. As Table VI-23 illustrates, the share of total collection points outside and inside post office lobbies has continued to grow relative to collection points in business and residential areas. The Postal Service has indicated to the Commission that it was Postal Service policy to relocate collection boxes that were located outside discontinued post offices.[23] With the advent of POStPlan, there may be fewer closed offices and collection boxes at Postal Service retail facilities will continue to be an important access point for customers.

[22] USPS Reply Comments at 22.

[23] 2011 ACD at 86.

Table VI–21—FY 2012 Wait Time in Line

Area	Fiscal Quarter/ Year	Average Retail Customer Experience Wait Time	
		FY 2012	FY 2011
Capital Metro			
	Quarter 1	2:38	
	Quarter 2	2:43	
	Quarter 3	2:08	
	Quarter 4	1:56	
	Fiscal Year	2:22	2:40
Eastern			
	Quarter 1	2:44	
	Quarter 2	2:41	
	Quarter 3	2:09	
	Quarter 4	2:01	
	Fiscal Year	2:24	2:26
Great Lakes			
	Quarter 1	1:58	
	Quarter 2	2:26	
	Quarter 3	1:42	
	Quarter 4	1:43	
	Fiscal Year	1:57	2:05
Northeast			
	Quarter 1	2:34	
	Quarter 2	2:33	
	Quarter 3	2:13	
	Quarter 4	2:11	
	Fiscal Year	2:23	2:35
Pacific			
	Quarter 1	3:47	
	Quarter 2	3:57	
	Quarter 3	2:13	
	Quarter 4	2:38	
	Fiscal Year	3:25	3:16
Southern			
	Quarter 1	2:53	
	Quarter 2	3:07	
	Quarter 3	2:15	
	Quarter 4	1:54	
	Fiscal Year	2:33	3:03
Western			
	Quarter 1	3:20	
	Quarter 2	3:22	
	Quarter 3	2:34	
	Quarter 4	2:31	
	Fiscal Year	2:58	3:07
National			
	Quarter 1	2:51	
	Quarter 2	2:58	
	Quarter 3	2:19	
	Quarter 4	2:08	
	Fiscal Year	2:34	2:45

Source: USPS-FY12-33.

Table VI–22—Number of Collection Points by Location-Type

Location Type	Year 2012	2011	2010	2006	Change in Number 2012-2006	Percent Change 2012-2006	Change in Number 2012-2011	Percent Change 2012-2011
Business	82,142	83,587	87,391	108,418	(26,276)	-24.2%	(1,445)	-1.7%
Residential	41,019	41,513	43,342	61,038	(20,019)	-32.8%	(494)	-1.2%
Post Office Outside	45,167	45,632	47,579	53,665	(8,498)	-15.8%	(465)	-1.0%
Post Office Lobby	39,236	39,175	39,636	37,110	2,126	5.7%	61	0.2%
Customer Lobby	3,817	3,920	2,729	4,057	(240)	-5.9%	(103)	-2.6%
Other	3,795	3,772	4,357	3,191	604	18.9%	23	0.6%
Contract Station	938	952	873	948	(10)	-1.1%	(14)	-1.5%
Mail Room	749	787	782	807	(58)	-7.2%	(38)	-4.8%
Customer Dock	262	264	337	464	(202)	-43.5%	(2)	-0.8%
Airport	152	143	138	152	-	0.0%	9	6.3%
Goverment Building	275	263	233	68	207	304.4%	12	4.6%
Approved Shipper	99	66	0	0	99		33	50.0%
Grand Total	**217,651**	**220,074**	**227,397**	**269,918**	**(52,267)**	**-19.4%**	**(2,423)**	**-1.1%**

Source: USPS-FY12-45.

Table VI–23—Percent of Total Collection Points by Fiscal Year

Location Type	2012	2011	2010	2006
Business	37.7%	38.0%	38.4%	40.2%
Residential	18.8%	18.9%	19.1%	22.6%
Post Office (combined)	38.8%	38.5%	38.4%	33.6%

Source: USPS-FY12-45.

The Greeting Card Association observes that in the preface to Library Reference USPS-FY12-33, the Postal Service states that its CPMS does not currently have the capability of tracking the number of collection boxes added during a specific fiscal year.[24] The Postal Service has stated that it is in the process of adding this function to the CPMS and anticipates being able to provide this information for FY 2014.[25] *The Commission encourages the Postal Service to add the collection box measurement function to the CPMS.*

Alternative Access

In addition to providing postal products and services at postal retail counters, the Postal Service has continued to expand postal access through additional marketing channels. For FY 2012, just over 39 percent of retail revenue was generated through means other than a postal retail counter. Table VI-24 identifies the FY 2012 revenue each retail channel generated, the share of total retail revenue each contributed and the percent change from revenue provided in FY 2011. The Postal Service had set a goal for FY 2011 of 35 percent of revenues to be generated

24 GCA Comments at 1.
25 Library Reference USPS-FY12-33.

from alternative marketing channels. This goal has been exceeded in FY 2012 where, as shown in Table VI-24, the percent of total retail revenue generated from alternative channels was 39.1 percent.

PC postage and digital postage meters allow customers who mail frequently to print postage and shipping labels. The proportion of revenue generated by PC postage has increased by over 66 percent from FY 2010 to FY 2012.

Table VI–24—Retail Revenue by Channel

Services	FY 2012 Revenue ($ Millions)	FY 2012 Share of Total Retail Revenue	FY 2012 Share Difference from FY 2011	FY 2011 Revenue ($ Millions)	FY 2011 Share of Total Retail Revenue	FY 2010 Revenue ($ Millions)	FY 2010 Share of Total Retail Revenue
Post Offices (WIR)	$10,627	60.9%	-3.6%	$10,940	64.5%	$12,133	69.3%
PC Postage	$3,604	20.7%	4.1%	$2,799	16.5%	$2,180	12.4%
Stamps Only Sales by Retail Partners	$1,226	7.0%	0.2%	$1,155	6.8%	$1,143	6.5%
Automated Postal Centers (kiosks)	$497	2.8%	-0.4%	$544	3.2%	$579	3.3%
Stamps by Mail/Phone/Fax	$517	3.0%	0.0%	$517	3.0%	$509	2.9%
Contract Postal Units	$376	2.2%	-0.4%	$434	2.6%	$454	2.6%
Click-N-Ship	$484	2.8%	0.1%	$462	2.7%	$423	2.4%
Other	$119	0.7%	0.1%	$103	0.6%	$94	0.5%
Total Retail Revenue	**$17,450**	**100.0%**		**$16,954**	**100.0%**	**$17,515**	**100.0%**

Source: CHIR No.2, question 5.

The share of revenues derived from APCs located in post office lobbies in larger facilities has declined from 3.3 percent in FY 2010 to 2.8 percent in FY 2012. The number of APCs has remained relatively steady since 2006. Table VI-25 shows the number of APCs for selected years. Postal Service surveys indicate 83 percent of residential customers and 83 percent of small/medium business customers find that a "self service mailing and shipping center is easy to use." Customer comments also included requests for more APCs and 24/7 access. In response to these comments, the Postal Service states it plans to add an additional 264 APCs by early 2013.[26]

Table VI–25—Number of Automated Postal Centers

Fiscal Year	Number of APCs
2012	2,132
2011	2,143
2010	2,142
2006	2,164

Source: USPS-FY12-45 and 2011 ACD.

[26] USPS 2012 Annual Report to Congress at 47.

Data provided by the Postal Service in this docket appear to indicate that many APCs currently in service are nearing the end of their service lives.[27] Thus, although the Postal Service has stated plans to add additional APCs beyond the 264 noted above, it will need to replace currently operational APCs nearing the end of their service lives.

Contract Postal Units (CPUs) and Community Post Offices (CPOs) offer a range of postal services other than just stamps. CPUs are usually located in a store or place of business and operated by a contractor who accepts mail from the public, sells postage and supplies and provides selected Special Services (*e.g.,* Postal Money orders or Registered Mail). Community Post Offices provide services in a community where no independent post office exists.[28] As shown on Table VI-26, the number of CPOs/CPUs declined significantly from FY 2011 levels as has their share of total retail revenues as indicated on Table VI-24.

Table VI–26—Number of Contract Postal Units

Office Type	Total at Start of FY 2012	Total at End of FY 2012	Net Change
Contract Postal Units (CPU)	2,513	2,196	(317)
Community Post Offices (CPO)	452	403	(49)
Total Contract Units	2,965	2,599	(366)

Source: USPS-FY12-45 and USPS-FY12-46.

Village Post Offices (VPOs) will provide a limited range of services that include the sale of First-Class Mail stamps, offer priority flat mail products, deliver to P.O. boxes and accept mail. VPOs are part of the Postal Service's "Approved Provider Network"—retail outlets for postal products and services that also include CPUs, Approved Shippers, stamps on consignment locations and CPOs.[29] VPOs were originally introduced as part of the Postal Service's Retail Access Optimization Initiative, which was a Postal Service proposal in 2011 to reduce the number of post offices in operation nationwide. VPOs are being located in community businesses, town halls or government centers. By being located at businesses and other places that customers already frequent, VPOs, the Postal Service contends, will offer Postal Service customers time-saving convenience and in many instances longer hours of operation than regular Post Offices. At the end of FY 2011, there were nine VPOs in operation. As of mid-December, 2012, there were 103 VPOs in operation. Over one-half of these were located in three states, Indiana, Kentucky, and Michigan. The Postal Service has stated that it intends to open a total of 400 Village Post Offices in FY 2013.[30] VPOs are limited substitutes for full service postal retail facilities.[31]

27 USPS Responses to CHIR No. 4, question 14.

28 USPS Pub. 32, January 2013, at 45.

29 USPS.com, Village Post Office fact sheet, February 1, 2013.

30 United States Postal Service FY 2012 Annual Compliance Report, December 28, 2012, at 36.

31 PRC Op. N2011-1 at 111.

Customer Experience

Introduction

For market dominant products, 39 U.S.C. 3652(a)(2)(B)(ii) requires the Postal Service to report "the degree of customer satisfaction with the service provided." In FY 2011, the Postal Service implemented a new Customer Experience Measurement (CEM) system for measuring customer experience and satisfaction. 2011 ACR at 11. CEM measures customer experience with market dominant products by asking survey participants to rate product satisfaction using a six-point scale: Very Satisfied, Mostly Satisfied, Somewhat Satisfied, Somewhat Dissatisfied, Mostly Dissatisfied, and Very Dissatisfied. *Id.* Reporting is segregated based on the type of customer: Residential, Small/Medium Business, and Large Business. The Postal Service aggregates Very/Mostly Satisfied in reporting to the Commission. Many of the more detailed results of the CEM are not reported to the Commission.

Customer Experience Measurement Results

Residential Customers

Approximately 300,000 residential (retail) customers participated in the CEM survey. Most residential customers responded positively to their postal experience in FY 2012. For example, 89 percent of respondents replied "*Very Satisfied*" or "*Mostly Satisfied*" when asked, "How satisfied are you with the Postal Service?" Respondents also expressed satisfaction with issues such as collection box locations, USPS tracking, and letter carriers. Table VI-27 illustrates that in FY 2012 residential customers remain generally satisfied with each market dominant product.

Table VI–27—CEM Results for Residential Customers

Residential Percent Rated Very/Mostly Satisfied

Mail Products and Services	FY 2010	FY 2011	FY 2012
First-Class Mail	93.7	94.2	94.7
Single-Piece International	85.9	86.6	87.5
Standard Mail	83.3	84.1	84.8
Periodicals	86.1	87	88
Single-Piece Parcel Post	88.2	89.2	89.3
Media Mail	87.6	88.4	89.1
Bound Printed Matter	85.4	86.2	87.2
Library Mail	86.7	87	87.9

Source: USPS-FY12-29 at 34 and 2011 ACD at 90.

Small/Medium Business Customers

The Postal Service received more than 310,000 survey responses from small/medium-sized businesses.[32] Eighty-four percent of respondents were *very* or *mostly* satisfied with the Postal Service. For example, 80 percent of respondents answered they were very or most likely to recommend the Postal Service to others. Almost 90 percent of respondents strongly agree or somewhat agree when asked "Are your post office clerks friendly/courteous?" Small and medium-sized businesses were relatively neutral, however, when asked about the reliability of the Postal Service's scheduled pickup.[33] Table VI-28 illustrates an increase in satisfaction by small/medium-sized businesses for each market dominant product.

Table VI–28—CEM Results for Small/Medium Business Customers

	Small/Medium Businesses Percent Rated Very/Mostly Satisfied		
Mail Products and Services	FY 2010	FY 2011	FY 2012
First-Class Mail	92.4	93.0	93.3
Single-Piece International	83.2	84.0	84.9
Standard Mail	85.9	87.0	87.9
Periodicals	83.8	85.1	86.1
Single-Piece Parcel Post	87.0	88.0	88.9
Media Mail	86.4	87.1	88.2
Bound Printed Matter	83.4	85.0	85.9
Library Mail	84.9	86.0	87.1

Source: USPS-FY12-29 at 34 and 2011 ACD at 90.

Large Business Customers

The Postal Service collected more than 3,000 survey responses from large businesses. Participating businesses had from 100 to more than 1,000 employees. Sixty-four percent of responses came from businesses with 100 to 500 employees. The National Postal Policy Council notes that these businesses are "less satisfied with market dominant products than are either residential or small business customers." NPPC Comments at 13. Specifically, it points to the decrease in satisfaction with First-Class Mail. Responses from large businesses were generally positive despite the eroding satisfaction for First-Class Mail. Respondents overwhelming answered very satisfied or mostly satisfied to questions about general satisfaction with postal experiences.[34] Large businesses were asked several questions regarding business relationships, postal contacts, knowledge of contact, timeliness of delivery, speed of responses, and courtesy. Similar to FY 2011, responses were generally positive with 79 percent very or mostly satisfied with postal services. Table VI-29 illustrates large businesses satisfaction with market dominant mailing products.

32 Sixty percent of businesses employ 1 to 4 persons.
33 Twenty-five percent of responses to scheduled pickup were neutral, somewhat disagree, or strongly disagree.
34 Seventy-eight percent of responses were very or most satisfied when asked "How satisfied are you with your most recent postal experience?"

Table VI–29—CEM Results for Large Business Customers

Mail Products and Services	FY 2010	FY 2011	FY 2012
	Large Businesses Percent Rated Very/Mostly Satisfied		
First-Class Mail	90.2	92.1	91.2
Single-Piece International	86.3	89.2	87.4
Standard Mail	84.5	85.6	85.7
Periodicals	82.8	84.3	84.9
Single-Piece Parcel Post	84.6	87.5	87.1
Media Mail	85.6	86.7	85.9
Bound Printed Matter	82.4	84.1	83.5
Library Mail	85.1	86.8	87

Source: USPS-FY12-29 at 34 and 2011 ACD at 90.

Commission Analysis

In order for the Postal Service to maintain its customer base, it should continue to study the results of its new CEM tool to enhance customer experience.

Chapter VII

Market Dominant Products

Introduction

This chapter presents the Commission's analysis, by class, of relevant financial data for each market dominant product, NSA, international product, incentive program, and market test.

In the financial analysis section for each class, the Commission evaluates the relationship of revenue to attributable cost for each product. This evaluation is focused on cost coverage, which is a relative measure, and contribution, an absolute measure. Section 3622 identifies 9 objectives and 14 factors that the Postal Service must balance when setting prices. One objective the Postal Service must consider is revenue adequacy, and another factor it must take into account is the requirement that each class of mail or type of mail service bear its direct and indirect postal costs when setting prices.

As the Postal Service, Congress and stakeholders evaluate solutions for the Postal Service's deteriorating financial situation, it is imperative to understand issues that contribute to the Postal Service's financial difficulties. These include the financial impact of loss making products and services. In FY 2012, 62.5 percent of the Postal Service operating deficit was due to products that generated insufficient revenues to cover their attributable costs.[1] These products also made no contribution towards the institutional costs of the Postal Service.

The PAEA grants the Postal Service expanded pricing flexibility while providing mailers stability and predictability via an inflation-based price cap. The informed and rational use of that pricing flexibility is an essential component of any long-term strategy to restore the Postal Service to profitability. The Postal Service must use its pricing flexibility to adjust prices for loss making products or risk the long-term sustainability of the postal system. In FY 2012, the Postal Service implemented one market dominant price increase, Docket No. R2011-2, as well as several pricing incentives. In some classes, the Postal Service leveraged its pricing flexibility to increase unit contribution. In other instances, such as Periodicals, the Postal Service did not fully leverage its pricing flexibility to maximize contribution.

Attributable (direct and indirect) costs accounted for only about 50 percent of total Postal Service costs in FY 2012. Adjusting prices to cover attributable costs is an important goal for the short-term operation of the Postal Service. Yet, the losses from some market dominant products have persisted for the five years since full implementation of the PAEA. The Postal Service has lost $7.5 billion from these market dominant products since FY 2008. These losses account for the majority of the Postal Service's operating loss over this period. For these reasons, product cost coverage and plans to bring loss-making products to full cost coverage are an important consideration.

[1] In FY 2012, loss-making products accounted for a $1.5 billion loss. The Postal Service operating deficit was $2.4 billion. 1.5/2.4 is 62.5 percent.

The principal findings for FY 2012 are summarized below:

- Nine market dominant products and services generated insufficient revenues to cover their attributable costs. The total loss from these products is $1.473 billion. This represents the amount necessary to reach 100 percent cost coverage; increasing the revenue from these products to cover the loss would still not result in any contribution towards the 40 percent of Postal Service costs categorized as institutional costs.
- Two classes of mail failed to cover their attributable cost: Periodicals ($670 million) and Package Services ($38 million).
- Two products accounted for $1.17 billion of the loss: Standard Flats ($528 million) and Outside County Periodicals ($642 million).

Each class section also contains a discussion of worksharing and other pricing issues. Methodological issues affecting the development of estimates of worksharing-related cost avoidances are addressed, the resulting cost avoidances are compared with the corresponding discounts, and the discounts and other pricing relationships are analyzed for consistency with the applicable statutory provisions.

The workshare findings for FY 2012 are summarized below:

- 40 workshare discounts exceeded avoided costs.
- 22 discounts qualified for a statutory exception.
- 16 discounts did not satisfy 39 U.S.C 3622(e)(2)
- The Commission is unable to determine if two discounts are consistent with section 3622(e) due to shortcomings in the underlying cost data.

In addition to presenting the principal findings, this introduction also includes the following: a discussion of FY 2012 rulemakings, the price cap, the basis for year-to-year comparisons in this chapter, and the relationship of the timing of the market dominant price adjustment and setting of worksharing discounts.

Rulemakings

The Commission calculates worksharing passthroughs using methodologies approved by the Commission prior to the filing of the ACR. In September, the Postal Service filed a petition to initiate proceedings to consider alternate methodologies, some of which affect cost models used for calculating cost avoidances.[2] Although this rulemaking was approved on February 14, 2013, it was not completed prior to the Postal Service filing its ACR. Thus, for the sake of consistency, analysis in the Commission's ACD reflects only methodologies approved prior to the filing of the ACR. The Commission emphasized this point in the last ACD, when it reiterated that the ACR should reflect approved methodologies in accordance with 39 C.F.R. 3050.10. 2011 ACD at 10.

[2] Docket No. RM2012-9, Petition of the United States Postal Service Requesting Initiation of a Proceeding to Consider Proposed Changes in Analytical Principles (Proposals Eight and Nine) September 28, 2012. The methodologies contained in Proposal Nine relate to the cost avoidance models for First-Class, Standard Mail, and Periodicals Flats.

Price Cap

In its ACDs, the Commission conducts a post-implementation review of the price cap. In accordance with the Commission's rules, when the Postal Service files a notice of market dominant price adjustments, it uses historical billing determinants to measure compliance with the applicable price cap. The Commission reviews the price adjustments on that basis and this is referred to as a pre-implementation review. However, the pre-implementation review does not account for the effect of price changes on billing determinants, *i.e.*, mailers' response to changes in price. For this reason, the Commission conducts a post-implementation review in the ACD.

The price adjustments from Docket No. R2011-2 took effect April 17, 2011, and were in effect until January 22, 2012. The post-implementation review of these prices is contained in Appendix A of this report.

Year-to-Year Comparisons

In this chapter, the Commission uses figures from past ACDs for year-to-year comparisons, which do not reflect any post-ACD revisions to figures in the Revenue, Pieces, and Weight Report (RPW). Because compliance analysis is based on current RPW figures rather than after-the-fact revisions, using previous ACDs for comparison purposes provides consistency and an easy-to-find reference point. Chapter IV contains an overview of the Postal Service's finances, whereas this chapter provides a more detailed analysis by product.

Timing of Pricing Adjustments and Worksharing Cost Avoidances

On October 18, 2011, the Postal Service updated its schedule of planned price changes and informed the mailing community that it planned to adjust market dominant prices in January of each year. This means the Postal Service provides notice of price adjustments for the upcoming year in October. On October 18, 2011, the Postal Service also filed a notice of market dominant price adjustment. The worksharing discounts in that price adjustment were developed using the most recent fiscal year data at the time, FY 2010 data. Thus, the worksharing discounts in effect in FY 2012 were developed using avoided cost data from 2 fiscal years earlier.

This shift in price adjustment timing has a noticeable effect on the accuracy of the information available for developing worksharing discounts. Both pricing flexibility and predictability are important goals of the PAEA, and the availability of current costing information is important to both market dominant pricing adjustments and the ACD process. In the FY 2012 ACD, the Commission has reviewed the results of a pricing adjustment that utilized out-of-date costing data for the setting of worksharing discounts. This lack of synchronization between the costs used to support the most recent price adjustment and the costs used in the most recent ACR ensures that some workshare discounts will not comply with the section 3622(e) requirements.

The Commission addressed this issue in the 2011 ACD at 18-19.[3] The issue persists in this ACD. Many worksharing discounts approved in Docket No. R2012-3 were based on 100 percent of the FY 2011 cost avoidances. When the discounts in effect in FY 2012 are compared to cost avoidances estimated for FY 2012, 40 discounts exceed avoided cost, leading to passthroughs of over 100 percent.

[3] The Commission also addressed this issue in its Section 701 Report, Analysis of the Postal Accountability and Enhancement Act of 2006, September 22, 2011. *See* pp. 37-40.

While many of these passthroughs can be justified using statutory exemptions, some cannot. For several discounts, the Postal Service cites changes in avoided cost between FY 2011 and FY 2012 as the reason the discount exceeds 100 percent. If the Postal Service used FY 2012 avoided cost data when setting Docket No. R2013-1 prices, the disconnect between costs and prices would not be as severe. However, the Postal Service did not have FY 2012 avoided cost data when it developed Docket No. R2013-1 prices.

The timing of pricing adjustments is not a statutory exemption for passthroughs over 100 percent. The Public Representative commented that cost avoidances in future years can be projected in advance of the ACR in the Postal Service's price adjustment filing.[4]

First-Class Mail

Introduction

First-Class Mail consists of six products: (1) Single-Piece Letters/Postcards, (2) Presort Letters/Postcards, (3) Flats, (4) Parcels, (5) Outbound Single-Piece First-Class Mail International, and (6) Inbound Single-Piece First-Class Mail International. The class had a volume of 69.4 billion pieces in FY 2012. First-Class Mail accounts for 44 percent of all Postal Service volume and 62.6 percent of all contributions toward institutional costs. Volume decreased by 5.3 percent and contribution decreased by 3.6 percent in FY 2012.

The principal FY 2012 findings for First-Class Mail are:

- With the exception of First-Class Mail Parcels, all domestic First-Class Mail products covered their attributable costs.
- Nine worksharing discounts exceeded avoided cost, and were not properly justified under section 3622(e).
- Five of the nine discounts that were excessive and not properly justified were appropriately re-aligned in Docket No. R2013-1.
- The Postal Service must either properly align the four excessive discounts that remain in the next market dominant price adjustment, or adequately support an applicable statutory exception.

Financial Analysis

The FY 2012 First-Class Mail cost coverage was 202.9 percent. As Table VII-1 shows, total First-Class Mail FY 2012 revenue was $30.4 billion, which covered its attributable cost of $15.0 billion and contributed $15.4 billion to institutional cost. Cost coverage for First-Class Mail increased from 199.0 percent in FY 2011 to 202.9 percent in FY 2012 due to a decrease in unit cost. Despite the increase in cost coverage, contribution decreased by approximately $572 million owing mostly to the continued loss of First-Class Mail volume. Thus, despite efficiency improvements indicated by the decrease in unit attributable cost and the Postal Service's use of virtually all its price cap authority, the contribution from First-Class Mail continues to decline. As noted in Chapter IV, this continued loss of volume reduces contribution and constrains the Postal Service's ability to cover its fixed costs.

[4] The Public Representative provides an analysis of rate elements associated with passthroughs of over 100 percent in the past five ACDs. The Public Representative showed that the year-to-year changes for many of these avoided costs are predictable. PR Comments at 41-49.

For FY 2012, unit attributable costs for First-Class Mail overall decreased by 2.1 percent. Compared with FY 2011, the unit attributable cost for Single-Piece Letters/Postcards decreased 1.1 percent; the unit cost for Presort Letters/Postcards increased 4.3 percent; the unit cost for Flats increased 0.2 percent; and the unit cost for Parcels increased 22.6 percent. The atypical unit cost increase for Parcels primarily reflects a change in the definition of Parcels rather than a sudden shift in Parcel cost behavior.

Table VII–1—First-Class Mail Fiscal Year 2012 Volume, Revenue, Cost Contribution, and Cost Coverage by Product

	Volume (000)	Revenue ($ 000)	Attributable Cost ($ 000)	Contribution to Institutional Cost ($ 000)	Revenue Per Piece (Cents)	Cost Per Piece (Cents)	Unit Contribution (Cents)	Cost Coverage
Single-Piece Letters	22,755,205	10,593,185	6,276,049	4,317,136	46.55	27.58	18.97	168.8%
Single-Piece Cards	1,158,305	370,622	297,063	73,559	32.00	25.65	6.35	124.8%
Total Single-Piece Letters and Cards	23,913,510	10,963,807	6,573,112	4,390,695	45.85	27.49	18.36	166.8%
Presort Letters	40,145,476	14,620,312	4,976,815	9,643,497	36.42	12.40	24.02	293.8%
Presort Cards	2,588,140	608,767	214,785	393,982	23.52	8.30	15.22	283.4%
Total Presort Letters and Cards	42,733,616	15,229,079	5,191,600	10,037,479	35.64	12.15	23.49	293.3%
Single-Piece Flats	1,407,190	2,115,529	1,284,282	831,247	150.34	91.27	59.07	164.7%
Presort Flats	641,986	557,631	506,763	50,868	86.86	78.94	7.92	110.0%
Total Flats	2,049,176	2,673,160	1,791,045	882,115	130.45	87.40	43.05	149.3%
Parcels	293,413	649,499	659,147	(9,648)	221.36	224.65	(3.29)	98.5%
Total Domestic First-Class Mail	68,989,715	29,515,545	14,214,904	15,300,641	42.78	20.60	22.18	207.6%
Total International First-Class Mail	649,854	917,923	783,764	134,158	141.25	120.61	20.64	117.1%
Total First-Class Mail	69,639,569	30,433,468	14,998,668	15,434,799	43.70	21.54	22.16	202.9%

Source: PRC-ACR2012-L1.

The cost coverage of Parcels fell from 110.0 percent in FY 2011 to 98.5 percent in FY 2012. The Postal Service attributes the decline to the transfer of commercial First-Class Mail Parcels to the competitive product list. After that transfer, only the retail component of Parcels remained. The retail component has a lower cost coverage than the commercial component. On January 27, 2013, prices for First-Class Mail Parcels increased by an average of 5 percent. While this should improve the cost coverage of Parcels, the Postal Service should ensure that this product covers its attributable cost through cost reductions and future rate adjustments.

Comments

The National Postal Policy Council (NPPC) and Pitney Bowes express concerns about the high cost coverage for commercial bulk First-Class Letters. NPPC Comments at 2. NPPC asserts that the relative contribution of Presort is too high compared with Single-Piece. *Id*. NPPC acknowledges that the cost coverage of the Presort Letters/Postcards product declined slightly from FY 2011, but notes that the unit contribution from Presort mail rose to an all-time high of $0.233. *Id*. NPPC asserts that the overpricing of commercial bulk First-Class Letters has led to the erosion of volume for that category. *Id* at 3. NPPC and Pitney Bowes contend that the Postal Service is unlikely to stem the volume losses as long as it continues to give Presort Letters/Postcards large price increases. *Id*.; Pitney Comments at 2. Pitney Bowes contends that the Postal Service "has not used its pricing flexibility to constrain price increases on its most profitable products as it should have." *Id*. at 2. It alleges that pricing to preserve and encourage the growth of First-Class Mail Presort Letters will create a more equitable price schedule and will improve the Postal Service's financial position. *Id*. NPPC urges the Postal Service to consider smaller increases, or even reductions, in Presort prices. NPPC Comments at 4.

Market dominant mailers have the protection of a price cap to shield them from excessive price increases. One objective of section 3622 is to allow the Postal Service pricing flexibility. Because the CPI cap is applied at the class level rather than the product level, it gives the Postal Service the ability to apply non-uniform price adjustments within a class. In the past, the Postal Service has often used its pricing flexibility in ways that benefit mailers of the Presort Letters/Postcards product. For example, in FY 2012 the Postal Service offered a free second ounce for all presort letters up to 2 ounces. Additionally, the 2012 Mobile Commerce and Personalization Program provided a discount to mailers that included a two-dimensional mobile barcode inside or on the mailpiece. These pricing strategies have the effect of mitigating price increases. Further, the information provided in the comments and reply comments is insufficient to justify a finding that the different price increases applied to categories of mail within First Class is unreasonable.

Worksharing

The following nine worksharing discounts exceeded the cost that worksharing avoids: (1) Qualified Business Reply Mail (QBRM) Letters; (2) QBRM Cards; (3) Mixed AADC Automation Letters; (4) AADC Automation Letters; (5) Mixed AADC Automation Cards; (6) 5-Digit Automation Cards; (7) ADC Automation Flats; (8) 3-Digit Automation Flats; and (9) 5-Digit Automation Flats. The calculations that form the basis of these avoided-cost passthroughs employ the accepted cost methodology. Below, the Commission discusses passthroughs that were above 100 percent in the order listed above.

QBRM

The discounts for QBRM Letters and Cards passthrough is 129.4 percent of avoided cost. *See* Tables VII-2 and VII-3.

In Docket No. RM2012-2, the Commission approved a change in the method used to estimate the avoided cost underlying the passthrough calculations for these discounts. When the Postal Service set the discounts that were in effect in FY 2012, that proceeding was still pending. The change in methodology was expected to increase the estimate of avoided costs. Although the Postal Service reduced the discounts from 2.3 cents to 2.2 cents, the reduction was not enough to prevent the passthroughs from exceeding the avoided cost estimate.

Table VII—2—First-Class Mail Letters, Workshare Discounts and Benchmarks

Type of Worksharing (Benchmark)	FY 2012 Year-End Discount (cents)	Unit Cost Avoidance (cents)	Passthrough
First-Class Mail Automation Letters			
Barcoding & Presorting			
Automation Mixed AADC Letters (Metered Letters)	4.6	4.5	102.2%
Automation AADC Letters (Automation Mixed AADC Letters)	3.0	2.6	115.4%
Automation 3-Digit Letters (Automation AADC Letters)	0.0	0.6	0.0%
Automation 5-Digit Letters (Automation 3-Digit Letters)	2.4	2.5	96.0%
First-Class Mail Non-automation Letters			
Presorting			
Non-automation Presort Letters (Metered Letters)	2.6	6.3	41.3%
Qualified Business Reply Mail			
Barcoding			
QBRM (Handwritten Reply Mail)	2.2	1.7	129.4%

Source: PRC-ACR2012-LR2.

The Postal Service justifies the excessive QBRM Letters and Cards discounts by citing section 3622(e)(2)(B), which allows excessive passthroughs if they are necessary to avoid rate shock. However, the Postal Service does not explain the nature or extent of the rate shock a higher passthrough would avoid. Its use of the “rate shock” exception is therefore not sufficiently supported. *The Commission finds that the discounts for QBRM Letters and Cards exceeded the amount of costs avoided and were not justified by any of the statutory exceptions. However, the Postal Service’s price change in Docket No. R2013-1 aligns the discounts with avoided cost, therefore, no further action is required with respect to these discounts.*

Automation Letters

The Postal Service calculates the following passthroughs of avoided costs for automation letters: Mixed AADC, 102.2 percent and AADC, 115.4 percent.

In Order No. 536, the Commission suspended the evaluation of the automation Mixed AADC letter discount with regard to section 39 U.S.C. 3622(e) pending the outcome of Docket No. RM2010-13, which determined the appropriate base or reference group for calculating the costs avoided by worksharing. That docket was resolved in FY 2012.[5] In Docket No. R2013-1, the Postal Service proposed, and the Commission approved, a 20 percent increase in the discount for this presort level that resulted in a passthrough below 100 percent of the most recently reported cost avoidance estimate. At the time, FY 2011 avoided cost estimates were the most recent available. A decrease in avoided costs from 5.9 cents to 4.5 cents between FY 2011 and FY 2012 caused the FY 2012 passthroughs for Mixed AADC Letters to exceed 100 percent.

The Postal Service justifies the excessive Mixed AADC Automation Letters passthrough by citing section 3622(e)(2)(D), which allows excessive passthroughs in order to not "impede the efficient operations of the Postal Service." 39 U.S.C. 3622(e)(2)(D). The Postal Service contends that the cost avoidance estimates are unsettled and therefore, it would be inefficient to make significant changes to the discount to reflect them.[6] In its Response to CHIR No. 3, question 2, the Postal Service claims that aligning the discount with avoided cost would impede the efficient management of the postal business as a whole. It asserts that adjusting the discount up and down based on avoided cost, would cause large year-to-year fluctuations in the amounts of volume sorted to the presort levels associated with the discount and could possibly even drive portions of the presort market out of business. However, the Postal Service does not explain what aspects of its operations would be impeded, nor in what way they would be impeded, if discounts were to be adjusted to restore 100 percent passthroughs. Its use of the "efficient operations" exception is therefore not sufficiently supported.

The Postal Service justifies the excessive AADC automation letters discounts by citing section 3622(e)(2)(B), which allows excessive passthroughs if they are necessary to mitigate rate shock. However, the Postal Service does not explain the nature or extent of the rate shock a higher passthrough would avoid. Its use of the "rate shock" exception is therefore not sufficiently supported.

The Commission finds that the Postal Service has not demonstrated that the excessive discounts for Mixed AADC Automation Letters and AADC Automation Letters qualify for the exceptions cited. With respect to the discount for AADC Automation Letters, the Commission recognizes that the Postal Service's reduction of the discount in Docket No. R2013-1 realigns the discount with avoided cost. Therefore, no further action is required. With regard to the discount for Mixed AADC Automation Letters, the Postal Service must either align the discount with avoided costs when it files its next general market-dominant price adjustment, or adequately support an applicable statutory exception.

Pitney Bowes is concerned that the Postal Service fails to passthrough the full workshare-related costs avoided in the discounts for First-Class Presort letters. Pitney Comments at 5. It argues that passing through less than 100 percent of avoided cost causes productive inefficiency, reduces social welfare, and results in excessive prices for Presort Letters. *Id*.

[5] *See* Docket No. RM2010-13, Order Resolving Technical Issues Concerning the Calculation of Workshare Discounts, April 20, 2012 (Order No. 1320).

[6] 2012 ACR at 10-11.

Additionally, Pitney Bowes asserts that the estimate of avoided costs for Automation 5-Digit letters is understated. *Id*. at 5-6. In Docket No. R2012-3, the Postal Service set the price for AADC Presorted letters equal to 3-Digit Presorted letters. On July 12, 2012, Pitney Bowes filed a petition to initiate an informal rulemaking to examine the proper benchmark for 5-Digit presort. In its petition, Pitney Bowes argues that since there is no longer either a requirement or a reward for presorting First-Class letters to the 3-Digit level, the rationale for using 3-Digit presort as the benchmark for calculating the cost avoided by presorting to the 5-Digit level needs to be re-examined. It suggests that logical candidates for a new benchmark for the Automation 5-Digit Letter category are either an AADC Automation Letter piece, or a hybrid of an AADC Automation Letter Piece and a 3-Digit Letter piece. The Commission established Docket No. RM2012-6 to consider this matter. That proceeding is pending.

Pitney Bowes also suggests that the method used by the Postal Service to make modeled costs for Presort Letters consistent with Cost and Revenue Analysis (CRA) costs can be improved. *Id*. at 6. It notes that its preliminary analysis reveals that the ratio of CRA-to-modeled costs remains substantially higher for non-incoming secondary costs than for incoming secondary costs. Therefore, it asserts the use of a uniform CRA adjustment factor is inaccurate. *Id*. It asserts that a more accurate CRA adjustment would increase workshare cost avoidances substantially, and further reduce the passthroughs currently exhibited by First-Class Mail Automation Letters. *Id*.

In Docket No. RM2010-13, the Commission noted that there are six specific operations through which some portion of workshared letters flow, and that, in theory, calculating a separate adjustment factor for each one might improve the accuracy of the CRA adjustment process. The Commission was concerned, however, that data may not be sufficiently reliable to implement adjustment factors specific to individual operations. As the costs are disaggregated more finely, the accuracy and reliability of the adjustment factors—which are partially based on sampled data—may deteriorate. The Commission was also concerned that Pitney Bowes did not adequately explain why the incoming secondary operation should be the only one to receive an adjustment factor specific to it. Since that docket, there have been no additional data or analysis developed to allay the Commission's concerns.[7]

Automation Cards

As shown in Table VII-3, the Postal Service calculates the following passthroughs of avoided costs for automation cards: Mixed AADC Automation Cards, 227.3 percent, and 5-Digit Automation Cards, 116.7 percent. The Postal Service justifies these discounts by citing section 3622(e)(2)(B), which allows excessive passthroughs if they are necessary to avoid rate shock.

With respect to the discount for Mixed AADC Automation Cards, the Postal Service contends that the cost avoidance associated with the discount has fallen quickly in the recent past and that changing the discount rapidly enough to match these reductions in the cost avoidance would lead to rate shock. The cost avoidance decreased from 2.7 cents in FY 2010 to 1.9 cents in FY 2011 to 1.1 cents in FY 2012. In Docket No. R2013-1, the Postal Service reduced the discount from 2.5 cents to 2.3 cents. In its Response to CHIR No. 3, question 1, the Postal Service discusses the magnitude of the price increases that would have to take effect to align this workshare discount with avoided

7 *See* Order No. 1320 at 53-55.

Table VII—3—First-Class Mail Cards Workshare Discounts and Benchmarks

Type of Worksharing (Benchmark)	FY 2012 Year-End Discount (cents)	FY 2012 Unit Cost Avoidance (cents)	FY 2012 Passthrough
First-Class Mail Automation Cards			
Barcoding & Presorting			
Automation Mixed AADC Cards (Non-automation Presort Cards)	2.5	1.1	227.3%
Automation AADC Cards (Automation Mixed AADC Cards)	1.1	1.3	84.6%
Automation 3-Digit Cards (Automation AADC Cards)	0.1	0.3	33.3%
Automation 5-Digit Cards (Automation 3-Digit Cards)	1.4	1.2	116.7%
Qualified Business Reply Mail			
Barcoding			
QBRM (Handwritten Reply Cards)	2.2	1.7	129.4%

Source: PRC-ACR2012-LR2.

cost, but it does not discuss any economic damage or disruption to business plans that would result from such a change. The Postal Service asserts that it intends to continue to phase out over time the portion of the discount above avoided costs.

With respect to the discount for 5-Digit Automation Cards, the Postal Service has not described the nature or extent of the rate shock that would occur if rates were to be adjusted to equal avoided costs.

The Commission finds that the Postal Service has not demonstrated that the excessive discounts for Mixed AADC Automation Cards and 5-Digit Automation Cards qualifies for the exceptions cited. With regard to the discount for Mixed AADC Automation Cards, the Postal Service must either align the discount with avoided costs when it files its next general market-dominant price adjustment, or adequately support an applicable statutory exception. With respect to the discount for 5-Digit Automation Cards, the Commission recognizes that the Postal Service's reduction of the discount in Docket No. R2013-1 realigns the discount with avoided cost. Therefore, no further action is required.

Automation Flats

The passthrough for First-Class Automation ADC Flats is 158.7 percent. The Postal Service justifies this passthrough by citing the "rate shock" exception authorized by section 3622(e)(2)(B). The Postal Service notes that it has been steadily reducing this passthrough and it intends to continue to reduce it until the discount equals its avoided costs. In its Response to CHIR No. 3, question 1, the Postal Service discusses the magnitude of the price increases that would have to take effect to align this workshare discount with avoided cost, but it does not explain the nature or extent of the rate shock a higher passthrough would avoid.

Table VII—4—First-Class Mail Flats Workshare Discounts and Benchmarks

Type of Worksharing (Benchmark)	FY 2012 Year-End Discount (cents)	Unit Cost Avoidance (cents)	Passthrough
First-Class Mail Automation Flats			
Barcoding & Presorting			
Automation ADC Flats (Automation Mixed ADC Flats)	10.0	6.3	158.7%
Automation 3-Digit Flats (Automation ADC Flats)	5.6	5.4	103.7%
Automation 5-Digit Flats (Automation 3-Digit Flats)	17.4	14.3	121.7%

Source: PRC-ACR2012-LR2.

The Commission finds that the Postal Service has not demonstrated that the excessive discount for Automation ADC Flats qualifies for the exception cited. Accordingly, the Postal Service must either align the discount with avoided cost when it files its next general market dominant price adjustment, or adequately support an applicable statutory exception.

The passthrough for 3-Digit Automation Flats is 103.7 percent. The Postal Service does not offer justification for the excessive passthrough. *The Commission finds that the Postal Service has not demonstrated that this discount qualifies for any of the exceptions authorized by section 3622(e)(2). In Docket No. R2013-1, the discount was realigned with avoided cost. Therefore, no further action is required.*

The First-Class Mail Automation Flats passthrough for 5-Digit Automation Flats is 121.7 percent. In Docket No. R2013-1, the approved rates resulted in a 100 percent passthrough of avoided cost for 5 Digit Automation Flats. However, the avoided cost calculation relied on FY 2011 costs. Based on the FY 2012 cost avoidance calculated in the FY 2012 ACR, the passthrough exceeds 100 percent. The Postal Service justifies this passthrough with the "rate shock" and "efficient operations" exceptions authorized by sections 3622(e)(2)(B) and (D). In its Response to CHIR No. 3, question 1, the Postal Service discusses the magnitude of the price increases that would have to take effect to align this workshare discount with avoided cost, but it does discuss any economic damage or disruption to business plans that would result from such a change. Additionally, in its Response to CHIR No. 3, question 2, the Postal Service claims that aligning the discount with avoided cost would impede the efficient management of the postal business as a whole. It asserts that adjusting the discount up and down based on avoided cost, would cause large year-to-year fluctuations in the amounts of volume sorted to the presort levels associated with the discount and could possibly even drive portions of the presort market out of business. The Postal Service does not describe what aspects of its operations would be impeded if discounts were adjusted to equal avoided costs, nor does it describe the nature or the amount of rate shock that would result if discounts were reduced to equal avoided costs.

The Commission finds that the Postal Service has not demonstrated that this discount qualifies for any of the exceptions authorized by section 3622(e)(2). Therefore, the Postal Service must either align the discount with avoided cost when it files its next general market dominant price adjustment, or adequately support an applicable statutory exception.

Pitney Bowes contends that these passthroughs are based on inaccurate cost avoidance estimates. It notes that under the Postal Service's proposed changes to the flats cost avoidance model in Docket No. RM2012-8, these passthroughs are much closer to 100 percent. Pitney Bowes urges the Commission to use the RM2012-8 flats cost model in making its compliance determination. Pitney Bowes Comments at 7.

Additionally, Pitney Bowes suggests that the CRA appears to overstate the cost of First-Class Mail Presort Flats, thereby understating the cost difference between Single-Piece and Presort Flats. Pitney Bowes urges the Postal Service to review the accuracy of First-Class Mail Presort Flats cost data and propose improved costing methods for use in future Annual Compliance Reports. *Id*.

Incentive Program

There was one incentive program in effect in FY 2012 that applied to First-Class Mail, the 2012 Mobile Commerce and Personalization Program. The primary goal of the promotion was to generate awareness of ways in which mobile technology can be integrated into mail campaigns. The program provided a discount on the eligible postage for commercial First-Class Mail and Standard Mail letters, postcards, and flats that included a two-dimensional mobile barcode inside or on the mailpiece. To qualify for the incentive, the mobile barcode was required to point to a mobile-optimized website that either facilitated mobile commerce or was personalized to the recipient. The program was in effect from July 1, 2012, to August 31, 2012. The Postal Service paid over $1.7 million in rebates for 229 million qualifying First-Class Mail pieces.

Periodicals

Introduction

The Periodicals class includes publications such as magazines, newspapers, journals, and newsletters. Eligibility criteria include a minimum amount of editorial (non-advertising) content.[8] This requirement establishes the Periodicals class as one with educational, cultural, scientific, and informational (ECSI) value. Periodicals is a preferred class of mail and receives several statutory discounts as identified in 39 U.S.C. 3626, such as a five percent discount for non-profit and classroom publications.

The Periodicals class is comprised of two products: Within County and Outside County. The Within County product is typically used by smaller circulation weekly newspapers for distribution within the county of publication. Pricing mainly reflects the number of pieces in a mailing, presort level, and total weight. The Outside County product consists of publications with a wide variety of circulation sizes, distribution patterns, and frequencies. Pricing is

[8] *See* Domestic Mail Manual: 707.4.0, Basic Eligibilty Standards; 707.6.0, Qualification Categories; and 707.4.13, Advertising Standards.

based not only on number of pieces and weight, but also on other elements such as how it is prepared (bundles, type of container), entry point, machinability, and automation capability.

The profiles of the two Periodicals products differ significantly in terms of volume and revenue. In FY 2012, approximately 631 million copies of Periodicals were mailed at Within County prices, and generated approximately $66 million in revenue for the Postal Service. In contrast, during the same year, 6.11 billion copies of Periodicals were mailed at Outside County prices, and generated approximately $1.66 billion in revenue for the Postal Service. The Postal Service filed several methodological changes to the Periodicals mail processing worksharing cost model prior to filing its FY 2012 ACR. In Docket No. RM2012-8, filed September 28, 2012, the Postal Service proposed changes to the Periodicals model, including the addition of allied operations. Those changes were approved by the Commission in Order No. 1656 on February 14, 2013.

As discussed below, in FY 2012, Periodicals unit costs increased and revenue per piece declined. *The Postal Service should review its Periodicals operational strategy to assess what cost savings initiatives are working, and how they can be improved.* The current Periodicals pricing structure was implemented in FY 2007. In the past 5 years, the Postal Service has not substantially changed worksharing discounts, sack, bundle or pallet charges. *The Postal Service should also review its pricing strategy to determine how to incentivize additional mailings that can be efficiently processed by current or planned operations. The Postal Service should also take the initiative to work closely with Periodicals mailers to pursue solutions to challenges relating to Periodicals.*

The principal FY 2012 findings for Periodicals are:

- Within County attributable costs exceeded revenues by $28 million, resulting in a cost coverage of 70.5 percent.
- Outside County attributable costs exceeded revenues by $642 million, resulting in a cost coverage of 72.2 percent.
- The Postal Service should leverage its pricing flexibility to incent more efficient mailer preparation to ameliorate losses from Periodicals.
- The rates for Periodicals did not satisfy 39 U.S.C. 3622(c)(2).
- In response to the Commission's FY 2011 ACD, the Postal Service listed nine cost savings changes designed to lower the cost of processing Periodicals. The Postal Service says that it has been unable to assess the success of these initiatives. In FY 2012 the unit attributable cost of Periodicals increased 3.7 percent to 36.5 cents per piece.
- Eleven workshare discounts exceed avoided costs, but are not inconsistent with the statute due to the ECSI exception in 39 U.S.C. 3622(e)(2)(C).
- The per piece revenue for Periodicals decreased slightly in FY 2012, even as the Postal Service implemented a price increase. The Postal Service should revisit its "across the board" approach to Periodicals pricing.
- Prices were in compliance with the preferred rate requirements identified in 39 U.S.C. 3626.
- The Postal Service needs to take the initiative to identify and implement solutions to Periodicals' worsening net revenue results. The Postal Service has not used its pricing tools to incent efficient Periodicals mailings that reduce costs and increase net revenue.

Financial Analysis

Background

Table VII-5 provides relevant financial data for Within County, Outside County, and the Periodicals class as a whole. It contains volume, revenue, attributable costs, contribution to institutional costs, and cost coverage for each Periodicals product in FY 2012.

Table VII-5 shows that Periodicals continue to make a negative contribution to institutional costs and continue to have cost coverage below 100 percent.

Table VII–5—Periodicals Mail Volume, Revenue, and Cost by Product FY 2012

Product	Volume (000)	Revenue ($000)	Attributable Cost ($000)	Contribution to Institutional Costs ($000)	Revenue Per Piece (Cents)	Cost Per Piece (Cents)	Unit Contribution (Cents)	Cost Coverage
Within County	631,286	67,269	95,398	(28,129)	10.6558	15.1117	4.4559	70.51%
Outside County	6,110,064	1,664,217	2,306,204	(641,987)	27.2373	37.7443	10.5070	72.16%
Total	6,741,351	1,731,486	2,401,602	(670,116)	25.68	35.62	0.0994	72.10%

Source: PRC-ACR2012-LR1.

Note: numbers in this section may not add due to rounding.

Comments on Compliance with Title 39

Commenters primarily address one issue: whether Periodicals prices were in compliance with title 39 in FY 2012 and whether the Commission should find the Periodicals class out of compliance for FY 2012 and order above cap price increases.

Valpak notes that the Postal Service losses related to Periodicals increased by 10 percent from FY 2011 to FY 2012. In FY 2012, the loss in contribution from Periodicals is $670 million, the largest loss since passage of PAEA. Valpak further notes that the Postal Service has lost $3.4 billion from Periodicals since the enactment of PAEA in FY 2007. Valpak argues that in FY 2012, prices for the Periodicals class were out of compliance with title 39. Specifically, Valpak contends that the FY 2012 prices violated section 3622(c)(2), section 101(d), section 101(a), section 3622(b)(5), and section 403(c). Valpak Initial Comments at 129.

Valpak advances four arguments for why the Commission must make a finding of noncompliance and take remedial action of increasing Periodicals prices. *Id*. First, the "Commission cannot and should not assume that Congress wanted Periodicals to be subsidized indefinitely and irrespective of the amount of the losses." *Id*. at 130. Second, the Postal Service pricing flexibility is limited by the CPI cap, but the Commission's authority to order remedies for noncompliance is not limited by the CPI cap. *Id*. at 131. Third, the Postal Service reports that it has implemented the cost savings strategies outlined in the Periodicals Mail Study, yet costs are still increasing faster than inflation. As such, Valpak states, the "Commission cannot reasonably rely on future additional cost savings to justify again failing to make a finding of noncompliance." *Id*. at 132. Fourth, the Commission's concerns regarding the impact of above-CPI price increases on Periodicals mailers do not justify inaction. Valpak states "if the Commission does not act now to start resolving Periodicals and begin moving toward compliance, the Commission is helping to guarantee that the PAEA ratemaking system is a failure, incapable of achieving the objectives and factors set forth in PAEA." *Id.* at 132.

Valpak urges the Commission to find the FY 2012 prices for Periodicals out of compliance with title 39 and that it order Periodicals prices to be "increased in the range of CPI plus 5.0 percent annually, until Periodicals revenue exceeds costs and makes some contribution to institutional costs (e.g., 105 percent cost coverage)." *Id*. at 134.

The Public Representative also notes the decline in Periodicals cost coverage from FY 2011 to FY 2012, which occurred in "spite of the Postal Service's claim that it has taken steps recommended in the Periodicals Mail Study to improve cost coverage." PR Comments at 26. The Public Representative requests the Commission direct the Postal Service to investigate and report on how Periodicals costs increased despite the cost savings initiatives. The Public Representative states that "to enable it to carry out its regulatory functions, the Commission should be informed by the Postal Service why the implementation of so many cost-saving measures resulted in an additional $60 million in negative contribution from Periodicals, the worst level since passage of the PAEA." *Id*. at 27.

Time urges the Commission to reject Valpak's argument that "it is time for the Commission to take punitive action against Periodicals mailers for failing to cover their costs again." Time Reply Comments at 1-2. Time addresses each of the four rationales provided by Valpak. First, Time notes that while Periodicals cost coverage has declined under the PAEA, the Periodicals class failed to cover its costs for the ten years immediately preceding adoption of the PAEA. Time states "in view of the history of Periodicals class, of which Congress was fully aware, there are no grounds at all for thinking that the mere duration of its continuing difficulties outstrips anything that Congress might have thought possible." *Id*. at 4. Second, Time states that the Postal Service has leveraged its pricing flexibility to the maximum extent possible. The Postal Service's inability to increase prices within the constraints of PAEA is "evidence of absence of grounds for a finding of noncompliance." *Id*. at 6. Third, Time states that the Postal Service is still in the process of implementing cost savings programs for Periodicals, and thus postal management has not yet fully brought to bear changes which could improve Periodicals cost coverage. *Id*. at 8. Time also appends comments by James O'Brien which discuss Periodicals costs savings programs. Fourth, Time states that Valpak has provided no evidence that the above-CPI cap increases will not harm Periodicals mailers. *Id*. at 8-9.

Time also addresses Valpak's argument that the Postal Service has discriminated against mailers in classes other than Periodicals by forcing them to cross-subsidize Periodicals. Time states that "there is no reason to believe that any non-Periodicals mailer has paid a penny more in postage than it would if Periodicals had been profitable." *Id*. at 9.

Magazine Publishers of America, Inc. and the Alliance of Nonprofit Mailers ("MPA/ANM" Joint Comments) also urge the Commission to reject Valpak's argument that Periodicals prices were out of compliance with title 39 in FY 2012. MPA/ANM note that the Public Representative's request that the Postal Service further investigate and report on Periodicals cost is “not an unreasonable request.” MPA/ANM Reply Comments at 2. MPA/ANM state that the Commission needs to “confront directly the elephant in the living room of Periodicals mail pricing: while the cap has ensured rate predictability and stability, it has not yet forced the Postal Service to rein in the out-of-control level of Periodicals costs despite large investments in automation equipment by the Postal Service, and large increases in worksharing by periodical publishers and their mail service providers.” *Id*. at 2.

Regarding Valpak’s argument that Periodicals prices were out of compliance with title 39, MPA/ANM discuss sections 3622(c)(2), 3622(b)(5), 403(c), 101(a), and 101(d). Concerning 3622(c)(2), MPA/ANM state that “for Periodicals mail, the CPI cap of 39 U.S.C. 3622(d) trumps the attributable cost floor of 39 U.S.C. 3622(c)(2).” *Id*. at 3. MPA/ANM further stated that “like the other ‘factors’ and ‘objectives’ of sections 3622(b) and (c), section 3622(c)(2) is subordinate to the ‘out-of-bound’ lines’ established by the CPI-based cap on class prices (3622(d)).” *Id*. at 3. MPA/ANM state that 39 U.S.C. 3622(c)(2) does “not, without more, make Periodicals mail out of ‘compliance with’ the Act as a whole.” *Id*. at 4. Regarding Valpak’s argument that Periodicals prices were out of compliance with section 3622(b)(5), MPA/ANM state that the “CPI-based price cap of section 3622(d) outweighs all of the objectives and factors combined.” *Id*. at 7.

MPA/ANM reject Valpak’s contention that Periodicals prices were out of compliance with section 403(c), arguing that the discrimination and preferences covered by 403(c) are “limited to price or services differences among mailers and services that are ‘like’ or similarly situated – a concept that is generally considered to be limited to ratepayers within the same rate class.” *Id*. at 7. MPA/ANM state that the differences in cost coverage between classes of mail are “governed by the rate reasonableness provisions of Section 3622, not the antidiscrimination provision of Section 403(c).” *Id*. at 8.

Concerning Valpak’s contention that Periodicals prices were out of compliance with section 101(a) and 101(d), MPA/ANM state that these “general policy desiderata are incorporated by reference into pricing in the catch-all ‘factor’ of section 3622(c)(14). Like section 3622(c)(2), section 3622(c)(14)—and, through it, section 101(a) and 101(d)—are subordinate to the CPI cap on class-average price increases imposed by section 3622(d).” *Id*. at 8.

In its Reply Comments, the Postal Service “concurs” with Valpak and urges the Commission to find Periodicals out of compliance and “finally determine what its remedial powers are.” Postal Service Reply Comments at 4. The Postal Service states that the cost coverage of Periodicals fell to 72.1 percent in FY 2012, and to defer the issue until 2016 “would be irresponsible.” In response to the Public Representative’s criticism that it failed to quantify the costs savings that have accrued from the efficiency measures implemented for Periodicals, the Postal Service contends that “it is impossible to isolate the cost-saving effects of a single efficiency measure when there are so many variables at play in flats processing.” *Id*. at 5.

Commission Analysis

In FY 2012, the cost coverage for Periodicals continued to decline. Periodicals revenue covered 72.1 percent of the $2.4 billion in attributable cost incurred by the class in FY 2012. This resulted in a negative contribution to institutional costs of $670 million. In the FY 2011 ACD, the Commission requested that the Postal Service continue the examination of Periodicals costs begun in the Periodicals Mail Study[9] and provide additional information on its progress in reducing Periodicals costs in FY 2012. While the Postal Service did not provide this information in its initial FY 2012 ACR, it discussed, but did not quantify the impact of the programs implemented in FY 2011 and FY 2012 to reduce Periodicals costs in response to CHIR Nos. 1 and 5.

In its response to CHIR No. 1, question 1, it states that it did not perform any analysis to isolate the cost savings resulting from the above initiatives because it may not be possible to isolate the cost savings from individual initiatives. The Postal Service also referred to its response to Question 7(b) of CHIR No. 1 in Docket No. ACR2011, filed on February 8, 2011. In that response, the Postal Service noted that its cost models are not designed to isolate reductions in manual handling costs, particularly given the fact that mail volumes, mail processing operations, mail classifications, and equipment sets change from year to year. The Postal Service added that while manual handling costs are captured in IOCS tallies and in the flats costs models (to the extent that the data is available in inputs that the models rely upon), the costs cannot be separated out.

Table VII-6 summarizes the financial results for Periodicals since the enactment of the PAEA.

Table VII–6— Periodicals Historical Financial Results (Millions)

Year	Volume	Revenue	Cost	Cost Coverage	Contribution
2007	8,795	$2,188	$2,636	83.01%	$(448)
2008	8,605	$2,295	$2,732	84.00%	$(437)
2009	7,953	$2,038	$2,680	76.04%	$(642)
2010	7,269	$1,879	$2,490	75.46%	$(611)
2011	7,077	$1,821	$2,430	74.94%	$(609)
2012	6,741	$1,732	$2,402	72.10%	$(670)
					$(3,417)

Source: PRC-ACR2012-LR4.

Since the enactment of the PAEA the cost coverage for Periodicals has declined from 84.0 percent to 72.1 percent. Table VII-7 details the unit cost, revenue, and contribution for Periodicals over the same time frame.

9 *Periodicals Mail Study, Joint Report of the United States Postal Service and Postal Regulatory Commission*, September 2011 (Periodicals Mail Study).

Table VII—7—Periodicals Unit Cost, Revenue, and Contribution FY 2007—FY2012

Year	Cost/Piece	Revenue/Piece	Contribution/Piece
2007	$0.2997	$0.2488	$(0.051)
2008	$0.3175	$0.2667	$(0.051)
2009	$0.3370	$0.2563	$(0.081)
2010	$0.3425	$0.2585	$(0.084)
2011	$0.3434	$0.2573	$(0.086)
2012	$0.3562	$0.2568	$(0.099)

Source: PRC-ACR2012-LR4.

In FY 2012, the average contribution per piece for Periodicals was negative 9.9 cents per piece, an increase of almost 15 percent over FY 2011. The cost coverage for Periodicals suffered both from increasing costs and slightly decreasing revenues. In FY 2012, the unit cost of Periodicals increased 3.7 percent to 35.6 cents. Per piece revenue for Periodicals decreased by 0.05 cents per piece to 25.68 cents. The decline in unit revenue in FY 2012 occurred despite the price increase of Docket No. R2012-3.

The decline in unit revenue was driven, in part, by an ongoing decline in advertising pounds and an increase in mailer worksharing.[10] The ongoing decline in advertising pounds increases the editorial percentage of Periodicals, which increased from 63.6 percent in FY 2011 to 64.7 percent in FY 2012. In market dominant price adjustments from Docket No. R2009-2 to Docket No. R2012-3, the Postal Service has pursued an "across the board" price increase strategy, aimed at "limiting the price increases for individual publications."[11] The Postal Service has many pricing tools at its disposal in Periodicals to incentivize efficient mailings and increase revenue.

In response to CHIR No. 3 question 6, the Postal Service provided USPS-FY12-NP33, referred to as the Periodicals "publication database" in the *Periodicals Mail Study*.[12] The Commission has developed an analysis of this database that replicates the information detailed on pages 23-30 of the Periodicals Mail Study for FY 2012, using the same methodology as the Joint Study updated for FY 2012. Most of the analysis and conclusions presented at that time remain accurate. One notable difference between FY 2009 and FY 2012 is that no Periodicals publication title covered its cost in FY 2012.[13]

10 Outside County Advertising ounces per piece declined 0.13 ounces, from 2.53 to 2.40, from FY 2011 to FY 2012. In FY 2012 62.96 percent of Outside County Periodicals were mailed at Carrier Route prices, and increase from 61.02 percent in FY 2011.

11 Docket No. R2009-2, United States Postal Service Notice of Market Dominant Price Adjustment (February 10, 2009) at 19. Docket No. R2011-2, United States Postal Service Notice of Market Dominant Price Adjustment (January 13, 2011) at 19. Docket No. R2012-3, United States Postal Service Notice of Market Dominant Price Adjustment (October 18 2011) at 23 and 24.

12 *Periodicals Mail Study* at 23-30.

13 PRC-ACR2012-NP-LR2.

This database is a valuable tool for assessing mailer usage of the postal network and should be leveraged by the Postal Service to improve both cost and service. The database uses unique mailer identification numbers to mask mailer identities. The identification numbers provided in USPS-FY12-NP33 are not crosswalked with the identification numbers used in the analysis of the FY 2009 database. Analyzing changes in Periodical mailer behavior between FY 2009 and FY 2012 could help further an understanding of the causes of declining revenue per piece over that period.

The Postal Service has stated that its recent goal for Periodicals pricing is to ensure that most Periodicals publications achieve near-CPI price increases.[14] The current Periodicals pricing structure was implemented in FY 2007. In the past five years, the Postal Service has not substantially changed worksharing discounts, or sack, bundle, or pallet charges. The Publication database is a valuable tool for both measuring and projecting the distribution of price increases. It is also a valuable tool for analyzing the opportunity to incentivize mailers to prepare mail that can be efficiently processed by the Postal Service. *The Postal Service should leverage this database in future years to achieve both increased contribution and reasonable distribution of price increases by publication.*

According to the Postal Service in response to CHIR No. 5 question 24, mail processing, delivery, and transportation unit costs for Periodicals increased in FY 2012. Table VII-8 details Periodicals unit mail processing costs from FY 2010 to FY 2012 by functional area.

Table VII–8—Periodicals OC Flats Mail Processing Cost 2010—2012 (cents per piece)

	2010	2011	2012	% Change 2010 to 2012
Plant Manual Processing	1.19	1.20	1.21	2%
NONMods	5.10	4.71	4.89	-4%
Plant Mechanized Processing	3.48	4.80	5.22	50%
Bundle Processing	2.60	2.51	2.45	-6%
Plant Allied	4.34	4.10	4.30	-1%
Other Allied	1.91	1.81	1.83	-4%
Total	**18.62**	**19.12**	**19.92**	**7%**

Source: PRC-ACR2012-LR4.

From FY 2010 to FY 2012, unit mail processing costs increased by 7 percent. This was driven by a large increase in "Plant Mechanized Processing" which is calculated using the Automated Flats Sorting Machine (AFSM), flats prep, Upgraded Flats Sorting Machine (UFSM), and Flats Sequencing System (FSS) cost pools. In response to CHIR No. 5, question 24, the Postal Service attributes the increase in mail processing cost to the FSS, stating "FSS raised costs for these three products as compared with FY 2010 costs," referring to Periodicals, Standard Mail Flats and Standard Carrier Route. The Postal Service also states "long-term initiatives often mean additional costs (capital and additional operating costs) have been incurred while the associated savings take longer to realize."

[14] Docket No. R2011-2, United States Postal Service Notice of Market Dominant Price Adjustment, January 13, 2011, at 19.

The increase in Periodicals mechanized processing costs is notable when evaluated in conjunction with mailing trends. From FY 2010 to FY 2012, the percentage of Periodicals volume presorted to Carrier Route increased from 59 percent to 63 percent. Similarly, mailer use of pallets, as opposed to sacks, has also increased. All things being equal, these improvements in mailer preparation and worksharing should decrease the cost of Postal Service processing. The increase in Postal Service processing cost highlights the importance of the Postal Service identifying and incentivizing mail that it can efficiently process. The ongoing decline in AFSM productivity also contributed to the increase in mechanized processing costs. AFSM Incoming Secondary productivity declined 7.1 percent from FY 2011 to FY 2012, and has declined 17.7 percent since FY 2008.[15]

In FY 2011, the Postal Service eliminated "Hot2C" practices, as discussed in the *Periodicals Mail Study*.[16] The goal of ending this practice was to reduce manual handlings and the unit manual mail processing cost. From FY 2010 to FY 2012, the unit plant manual processing cost increased by two percent. In response to CHIR No. 5, the Postal Service stated "[w]ith the interplay of other programs and initiatives...and value declines, it is not feasible to isolate the effect of the elimination of Hot2C practices on manual processing."

One functional processing section where unit costs have steadily decreased from FY 2010 to FY 2012 is "Bundle Processing," which is calculated using Automated Package Processing System (APPS), Small Parcel Bundle Sorter (SBPS), Automated Parcel Bundle Sorter (APBS), and Pouching cost pools. The Postal Service has recently deployed APBS as part of its "Flats Strategy." With the automated machines, SPBS/APBS productivity improved by 4.4 percent from FY 2011 to FY 2012.

As in FY 2011, Valpak's concerns about cost coverage lead it to conclude that the Commission should make a finding of noncompliance for Periodicals prices for FY 2012.

Despite the demonstrated cost coverage concerns raised by Valpak, the Commission does not find the rates and fees for the Periodicals class to be out of compliance at this time.

The Commission agrees with the Postal Service that the Periodicals class did not meet the "requirement that each class of mail or type of mail service bear the direct and indirect postal costs attributable to each class or type of mail service." 39 U.S.C. 3622(c)(2). The Postal Service has outlined substantial initiatives it has implemented to address the high costs of processing and delivering Periodicals, following some of the recommendations from the *Periodicals Mail Study*. The Commission recognizes that operational changes implemented by the Postal Service in FY 2011 and FY 2012 will take time to achieve measurable results. *Moreover, the Postal Service still has access to pricing tools to incent efficient mailings that reduce costs and increase net revenue. However, it must take further action now to address this situation. The Postal Service needs to take the initiative to identify and implement solutions to Periodicals' worsening net revenue results.*

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15 *See* CHIR No. 5, question 23.

16 Hot2C, also known as Hot Periodicals or Hot Pubs, was an unofficial practice that took place in many processing facilities and delivery units to create awareness of selected publications. This practice resulted in selected publications receiving expedited mail processing via manual processing.

The FY 2012 results for Periodicals highlight the importance of achieving measurable progress, and achieving it quickly. While the Postal Service eliminated the "Hot2C" program encouraging manual mail processing of Periodicals in FY 2011, manual processing costs continued to increase. Further, the Postal Service has not developed the information needed to assess and enhance the success of its cost savings initiatives. Generally, cost savings programs or initiatives target one or more specific activities to produce cost savings. These programs should have specific measurable targets by which the benefits of the program can be evaluated. The Postal Service did not achieve higher Periodicals revenue per piece in FY 2012 despite its pricing flexibility and a price increase. At this juncture, it does not appear that the strategy of "across the board" price increases for Periodicals allows the Postal Service to take advantage of its opportunities to increase revenues from Periodicals.

The cost saving programs implemented by the Postal Service can be enhanced through use of the Postal Service's pricing flexibility. There is sufficient room within the price cap to apply different rate increases to different products and rate categories. As discussed in the worksharing section, the Postal Service has not used its pricing flexibility to incentivize more efficient mailer preparation. The Postal Service should be able to phase in substantial changes to workshare discounts to align them better with the avoided costs. Bundle and container prices could also be altered to better reflect costs experienced by the Postal Service. The Commission appreciates the concerns raised by all the parties in this matter.

In the *Periodicals Mail Study*, the Commission committed to work with the Postal Service to improve the cost coverage of Periodicals. In FY 2012, the Postal Service was unable to decrease unit cost, or increase unit revenue. While the initiatives implemented by the Postal Service were not sufficient to prevent increases in Periodicals costs in FY 2012, the Commission remains optimistic that, with Postal Service and industry support, these initiatives can be leveraged to achieve measurable results.

The Postal Service must pursue the considerable opportunities identified in FY 2012 to reduce the costs of handling flats. The Commission is open to further dialogue in FY 2013 to assist the Postal Service in making progress in reducing Periodicals costs, and measuring that progress.

Worksharing Discounts

One Within County passthrough exceeded 100 percent in FY 2012: High Density. Additionally, ten Outside County passthroughs, identified in Table VII-9, exceeded 100 percent.

Discounts that exceed avoided costs are permissible if a statutory exception applies. *See* 39 U.S.C. 3622(e). The Postal Service justifies the Periodicals discounts that exceeded 100 percent on the basis of section 3622(e)(2)(C), which authorizes workshare discounts greater than avoided cost if provided in connection with a subclass that consists exclusively of mail matter with ECSI value. 2012 ACR at 28. In FY 2012, one Periodicals worksharing discount, the pre-barcoding of Nonmachinable Automation MADC Flats was 45 times the avoided cost. As recently as FY 2009, this discount was under 100 percent of the avoided cost. Periodicals operations have changed since FY 2009. Specifically, the UFSM that was used in FY 2009 to sort non-machinable flats was not used in many facilities

Table VII–9—Periodicals Workshare Discounts Exceeding Avoided Costs in FY 2012

Type of Worksharing	Within Country	Discount	Avoided Cost	Passthrough
	High Density	1.6	1.6	101.1%
Type of Worksharing Presorting (dollars/piece)	Outside County	Discount	Avoided Cost	Passthrough
	Machinable Non-automation 5D Flats	10.0	9.2	108.7%
	High Density	3.1	1.6	193.8%
	Machinable Automation 5D Flats	8.7	8.3	104.8%
	Non-machinable Non-auto ADC Flats	11.8	9.7	121.6%
	Non-machinable Non-auto 3D/SCF Flats	7.6	2.0	380.0%
	Non-machinable Automation 3D/SCF Flats	6.2	0.7	885.7%
Barcoding (dollars/piece)				
	Non-machinable Automation MADC Flats	4.5	0.1	4500.0%
Presorting Automation Letters (dollars/piece)				
	ADC Automation Letter	4.0	2.1	190.5%
	3-Digit Automation Letter	2.1	0.4	525.0%
	5-Digit Automation Letter	6.2	2.0	310.0%

Source: PRC-ACR2012-LR4.

in FY 2012. This has eroded the value of incentivizing mailers to prebarcode non-machinable flats. This example highlights how the Postal Service has not updated Periodicals prices to reflect current operational reality.

Comments on Worksharing Discounts

Time comments that the Carrier Route passthrough was 71.3 percent in FY 2012. Both Time and MPA/ANM note the increase in the percentage of Periodicals presorted to Carrier Route since the enactment of the PAEA. Time asserts that the combination of high Carrier Route volume and low Carrier Route passthrough "should make carrier route mail a significant contributor to cost coverage improvement." Time Reply Comments at A-2. In the "Mailflow Optimization Matrix" ("MOP") presented by Time in the O'Brien appendix, Periodicals pricing signals are discussed. Specific recommendations include 16 pricing changes within the current pricing structure and 19 price changes within a new pricing structure. Changes within the current structure include increasing the discount between 5-digit and carrier route. Changes within a new pricing structure include creating FSS piece, bundle and container prices (cost based).

Commission Analysis

The Periodicals class qualifies for ECSI consideration; therefore, the Commission finds that the Outside County discounts that exceed avoided costs are consistent with section 3622(e). Nine categories that had passthroughs greater than 100 percent in Docket No. R2011-2 still have passthroughs greater than 100 percent with the prices recently approved in Docket No. R2013-1.[17] *See* Docket No. R2013-1, PRC-LR-2. While the Postal Service justifies worksharing discounts of over 100 percent in Periodicals, citing 39 U.S.C 3622(e)(2)(C), other factors and objectives highlight the importance of sending efficient pricing signals. As discussed above, the Postal Service has not fully leveraged its pricing flexibility to maximize the contribution from Periodicals. In FY 2012, one Periodicals discount was 45 times larger than the avoided cost. Better aligning discounts with avoided cost would allow mailers and the Postal Service to maximize efficiency.

With regard to the carrier route passthrough focused on by Time, Table VII-10 details the passthrough for 5-Digit Machinable Automation pieces and or Basic Carrier Route pieces since FY 2008.

Table VII—10—Carrier Route and 5-Digit Automation Passthroughs

	FY 2008	FY 2009	FY 2010	FY 2011	FY2012
CR Basic	88.15%	71.52%	71.05%	69.48%	71.33%
5-Digit Automation	61.37%	96.63%	102.38%	106.17%	104.82%

Source: Dockets Nos. ACR2008—ACR2012, Periodicals Library References.

The 9.8 cent differential between 5-Digit and Carrier Route has remained unchanged since FY 2008. The *Periodicals Mail Study* found that Carrier Route presorted pieces were among "the rate elements that provide the most contribution per piece."[18] The Periodicals rate elements provide the Postal Service with pricing flexibility. The Postal Service has the option to incent Carrier Route presorted pieces to achieve more profitable mail in Periodicals.

As a higher percentage of Periodicals volume is processed on the FSS, Periodicals mail will have two sets of avoided costs; one set of avoided costs for mail processed in an FSS environment and another set of avoided costs for mail processed in facilities without the FSS. In FY 2012, 18.8 percent of all flats were processed on the FSS. The modeled mail processing cost for Carrier Route Periodicals increased to 2.1 cents per piece in FY 2012 due to Carrier Route mail processed on the FSS. In FY 2012, 17.3 percent of Carrier Route Periodicals were estimated to have been processed on the FSS. The data required to obtain census level data regarding the class and presort level of the mail processed on the FSS was not available in FY 2012. The cost of FSS processing was 12.1 cents per piece in FY 2012. Carrier Route should retain significant value to the Postal Service in non-FSS zones. Carrier Route mail will continue to avoid expensive mechanical sorting operations in non-FSS zones.

The Postal Service has stated "it has no plans to adjust its Periodicals price schedules to differentiate between FSS and non-FSS zones."[19] The Postal Service may find it advantageous to reconsider. Utilizing FSS zone pricing would allow the Postal Service to efficiently incentivize Carrier Route mail where the FSS is not available, and

[17] Tables displaying the full range of discounts, avoided costs, and passthroughs for Within County and Outside County Periodicals, as well as prices, bottom-up costs, and price-cost ratios for bundles, sacks, and pallets, appear in the tables at the end of this section.

[18] *Periodicals Mails Study* at 26.

[19] Docket No. RM2012-2, Reply Comments of the Postal Service Regarding Proposal Eighteen (February 23, 2012), at 6.

prevent counterproductive presorting of the mail where the FSS is available. The FSS requires very different mail preparation characteristics to maximize its operational potential, and the Postal Service should fully explore pricing to encourage mailer preparation that allows cost minimization. In a price cap environment, pricing to maximize efficiency and contribution is particularly important.

While the Postal Service does not incentivize FSS prepared mail with a price signal, it does have pallet, bundle, and piece presort options for Periodicals. In FY 2012, 2.6 percent of all Periodicals pallets were FSS facility or FSS scheme, 1.9 percent of all Periodicals bundles were prepared as FSS bundles, and 4.3 percent of Periodicals volume were presorted for processing directly on the FSS. The percent of Periodicals pieces prepared for efficient FSS entry was greater than for Standard mail.[20] The adoption of FSS entry options by Periodicals mailers highlights the benefit of a price structure that sends efficient pricing signals to mailers. Periodicals mailers pay for each pallet and bundle. The ability to prepare mailings for the FSS, instead of a Carrier Route, provides both the mailer and the Postal Service savings. Efficient pricing signals would help the Postal Service maximize the benefit of its FSS investment. *The Commission recommends the Postal Service leverage its pricing flexibility to improve Periodicals pricing options and worksharing passthroughs to incent more efficient mailer preparation and increase contribution from Periodicals.*

Price-Cost Ratios for Bundles and Containers

Discrete pricing for Outside County bundles, sacks and pallets was introduced in Docket No. R2006-1. The prices, bottom-up costs, and ratios of price to bottom-up cost for each combination of item, presort level, and entry level are shown in the tables at the end of this section. These price-cost ratios can be thought of as similar to worksharing discounts, in the sense that they provide incentives for cost-reducing mail preparation behavior. Unlike worksharing discounts they do not explicitly relate discounts to the costs avoided by greater mailer preparation. Price-cost ratios are used to describe how much of a cost is recognized in a given price element. The price-cost ratios for bundles, sacks, and pallets are significantly below 100 percent. Price-cost ratios range from a low of 7.2 percent for a mixed ADC pallet entered at the Origin Network Distribution Center (ONDC), to a high of 64.3 percent for a 5-Digit pallet entered at the ONDC.

Comments

No commenter specifically discussed the pricing of Periodicals sacks, pallets, and bundles for FY 2012. The IDEAlliance's Mail Flow Optimization Matrix (MOP) provided by Time presented several future pricing ideas, such as aligning container prices with cost avoidances and creating pallet pricing for FSS zones.

Commission Analysis

In the most recent market dominant price adjustment, Docket No. R2013-1, the Postal Service used its pricing flexibility to increase the prices of pallets, on average, by 2.8 percent. The Postal Service increased sacks, on

[20] In FY 2012, 0.19 percent of Standard Mail Flats and Standard Carrier Route pallets were prepared as FSS pallets. 0.09 percent of Standard Mail Flats and Standard Carrier Route bundles were prepared as FSS bundles. 0.29 percent of Standard Mail Flats and Standard Carrier Route volumes were prepared as FSS presorted pieces.

average, by 2.3 percent. This means that the gap between sack price-cost ratios and pallet price-cost ratios will grow in FY 2013.

In FY 2007, when the current Periodicals rate design was implemented, 24.7 percent of Periodicals were mailed in sacks. By FY 2012, that number had declined to 14.5 percent. In FY 2007, 16.9 percent of Periodicals sacks were entered at the Destination Bulk Mail Center (DBMC) or further downstream. In FY 2012, 20.5 percent of Periodicals sacks were entered at the Destination Network Distribution Center (DNDC) or further downstream. Although the Postal Service has not substantially altered the price relationship between sack and pallet charges during this period, mailers have nevertheless responded to the nominal price signals. This suggests that stronger price signals will induce even more efficient mailer behavior. Because the Postal Service has not substantially changed the passthroughs for bundle, sack, and pallet prices since FY 2007, it may not be reasonable to change prices to maximize efficiency in one price adjustment. For this reason, the Postal Service should work with mailers to determine where best to begin increasing incentives to achieve efficiency gains as large as possible without a substantial adverse effect on mailers. The Postal Service should work with mailers to identify and incentivize mail that can be efficiently processed by current Postal Service operations.

The Commission recommends the Postal Service leverage its pricing flexibility to improve Periodicals bundle and container pricing to incent more efficient mailer preparation and increase contribution from Periodicals.

Table VII–11-Within County Passthroughs, FY 2012

Type of Worksharing	Discount	Avoided Costs	Passthrough
Presorting (dollars / piece)			
3-Digit Presort	1.2	3.6	33.2%
5-Digit Presort	1.3	12.2	10.6%
CR Basic	4.7	16.9	27.9%
High Density	1.6	1.6	101.1%
Saturation	1.4	4.1	33.8%
3-Digit Automation Letter	1.0	1.5	66.7%
5-Digit Automation Letter	0.2	2.0	10.0%
Barcoding (dollars/piece)			
Basic Automation Flats	1.6	6.3	25.4%
3-Digit Automation Flats	1.2	6.2	19.4%
5-Digit Automation Flats	0.6	2.9	20.6%
Dropship (dollars/piece)			
DDU Dropship	0.8	1.2	65.9%

Source: PRC-ACR2012-LR4.

Table—VII-12-Outside County Passthroughs, FY 2012

Type of Worksharing	Discount	Avoided Costs	Passthrough
Pre-sorting (dollars/piece)			
Machinable Non-automation ADC Flats	3.5	5.4	64.8%
Machinable Non-automation 3D/SCF Flats	1.7	4.0	42.5%
Machinable Non-automation 5D Flats	10.0	9.2	108.7%
CR Basic	10.7	15.0	71.3%
High Density	3.1	1.6	193.8%
Saturation	2.0	4.1	48.8%
Machinable Automation ADC Flats	2.7	4.7	57.4%
Machinable Automation 3D/SCF Flats	1.5	3.5	42.9%
Machinable Automation 5D Flats	8.7	8.3	104.8%
Non-machinable Non-auto ADC Flats	11.8	9.7	121.6%
Non-machinable Non-auto 3D/SCF Flats	7.6	2.0	380.0%
Non-machinable Non-auto 5D Flats	12.0	14.1	85.1%
Non-machinable Automation ADC Flats	9.8	11.4	86.0%
Non-machinable Automation 3D/SCF Flats	6.2	0.7	885.7%
Non-machinable Automation 5D Flats	11.0	14.0	78.6%
Pre-barcoding (dollars/piece)			
Machinable Automation MADC Flats	3.2	3.3	97.0%
Non-machinable Automation MADC Flats	4.5	0.1	4500.0%
Presorting Automation Letters (dollars/piece)			
ADC Automation Letter	4.0	2.1	190.5%
3-Digit Automation Letter	2.1	0.4	525.0%
5-Digit Automation Letter	6.2	2.0	310.0%

Source: PRC-ACR2012-LR4.

Table VII–13—Outside County Bundle Price/Cost Ratios, FY 2012

Container Level	Bundle Level	Price ($)	Bottom-up Cost ($)	Price as Percent of Cost
Mixed ADC	MADC	0.079	0.210	37.6%
	ADC	0.208	0.558	37.3%
	3-D/SCF	0.276	0.752	36.7%
	5-D	0.285	0.819	34.8%
	Firm Bundle	0.185	0.973	19.0%
ADC	ADC	0.115	0.317	36.3%
	3-D/SCF	0.190	0.512	37.1%
	5-D	0.206	0.568	36.3%
	CR	0.325	0.794	40.9%
	Firm Bundle	0.154	0.779	19.8%
3-D/SCF	3-D/SCF	0.129	0.315	41.0%
	5-D	0.150	0.358	41.9%
	CR	0.288	0.570	50.5%
	Firm Bundle	0.142	0.565	25.1%
5-D/CR	5-D	0.145	0.315	46.0%
	CR	0.152	0.296	51.4%
	Firm Bundle	0.079	0.306	25.8%

Source: PRC-ACR2012-LR4.

Table VII–14—Outside County Sack Price/Cost Ratios, FY 2012

Sack Level	Entry Point	Price ($)	Bottom-up Cost ($)	Price as Percent of Cost
Mixed ADC	ONDC	0.437		
	OSCF	0.437	2.759	15.8%
	OADC	0.437	2.250	19.4%
ADC	OSCF	2.092	6.430	32.5%
	OADC	2.092	6.266	33.4%
	ONDC	2.092	5.52	37.9%
	DNDC	1.457	4.113	35.4%
	DADC	0.833	2.25	37.0%
3-D/SCF	OSCF	2.186	6.893	31.7%
	OADC	2.186	6.572	33.3%
	ONDC	2.186	5.735	38.1%
	DNDC	1.562	4.237	36.9%
	DADC	1.249	4.000	31.2%
	DSCF	0.833	2.250	37.0%
5-D/CR	OSCF	2.810	8.699	32.3%
	OADC	2.810	7.996	35.1%
	ONDC	2.810	7.207	39.0%
	DNDC	2.082	5.757	36.2%
	DADC	1.770	4.947	35.8%
	DSCF	1.353	3.744	36.1%
	DDU	0.937	2.509	37.3%

Source: PRC-ACR2012-LR4.

Table VII–15— Outside County Pallet Price/Cost Ratios, FY 2012

Pallet Level	Entry Point	Price ($)	Bottom-up Cost ($)	Price as Percent of Cost
Mixed ADC	ONDC	3.365	46.647	7.2%
	OADC	3.365	26.378	12.8%
	OSCF	3.365	46.000	7.3%
ADC	OSCF	33.375	70.756	47.2%
	OADC	33.375	63.318	52.7%
	ONDC	33.375	55.306	60.3%
	DNDC	23.127	46.647	49.6%
	DADC	12.803	26.378	48.5%
3-D/SCF	OSCF	39.505	84.136	47.0%
	OADC	39.505	78.161	50.5%
	ONDC	39.505	64.918	37.9%
	DNDC	24.572	51.028	41.9%
	DADC	21.372	45.665	46.8%
	DSCF	11.460	25.142	45.6%
5-D/CR	OSCF	50.875	104.413	48.7%
	OADC	50.875	91.310	55.7%
	ONDC	50.875	79.108	64.3%
	DNDC	32.936	66.258	49.7%
	DADC	31.180	63.615	49.0%
	DSCF	21.062	42.728	49.3%
	DDU	1.652	3.203	51.6%

Source: PRC-ACR2012-LR4.

Standard Mail

Introduction

Standard Mail is a market dominant class that consists of six products: (1) Letters; (2) Flats; (3) Parcels; (4) Carrier Route; (5) High Density and Saturation Letters; and (6) High Density and Saturation Flats/Parcels. In FY 2012 Standard Mail volume was 79.8 billion pieces, a decrease of 4.9 billion pieces from the 84.7 billion pieces in FY 2011. Despite the decrease in volume, Standard Mail accounted for 50.3 percent of total mail volume, and 22.7 percent of total contribution to institutional costs. Standard Mail's contribution as a share of total contribution has decreased from 23.4 percent in FY 2011.

The principal FY 2012 findings for Standard Mail are:

- Standard Mail contributed $5.5 billion to institutional costs.
- Standard Mail Flats had an 80.9 percent cost coverage, 1.4 percentage points higher than FY 2011, but resulting in a $528 million loss.
- Standard Mail Parcels had an 85.5 percent cost coverage, 0.5 percentage points lower than FY 2011, resulting in a $49.0 million loss.
- Sixteen workshare discounts exceeded avoided costs.
- Four discounts were properly justified under section 3622(e).
- Six commercial discounts were not properly justified under section 3622(e).
- Four nonprofit discounts were not properly justified under section 3622(e).
- The Commission was unable to evaluate whether one commercial discount and one nonprofit discount were consistent with the statute.

Financial Analysis

In FY 2012, the total revenue for Standard Mail was $16.7 billion, which covered its attributable costs of $11.2 billion, and resulted in a 149.0 percent cost coverage (*see* Table VII-16). Standard Mail contributed $5.5 billion to institutional costs, a 3.5 percent decrease from FY 2011.

The overall cost coverage for Standard Mail increased slightly to 149.0 percent from 147.6 percent in FY 2011. Standard Mail volume decreased 5.8 percent, or nearly five billion pieces. Unit revenue and unit cost decreased from FY 2011 by 0.1 cents and 0.2 cents, respectively. Despite a 0.1 cent increase in unit contribution, the decrease in volume resulted in Standard Mail contributing $252 million less to institutional costs compared to FY 2011.

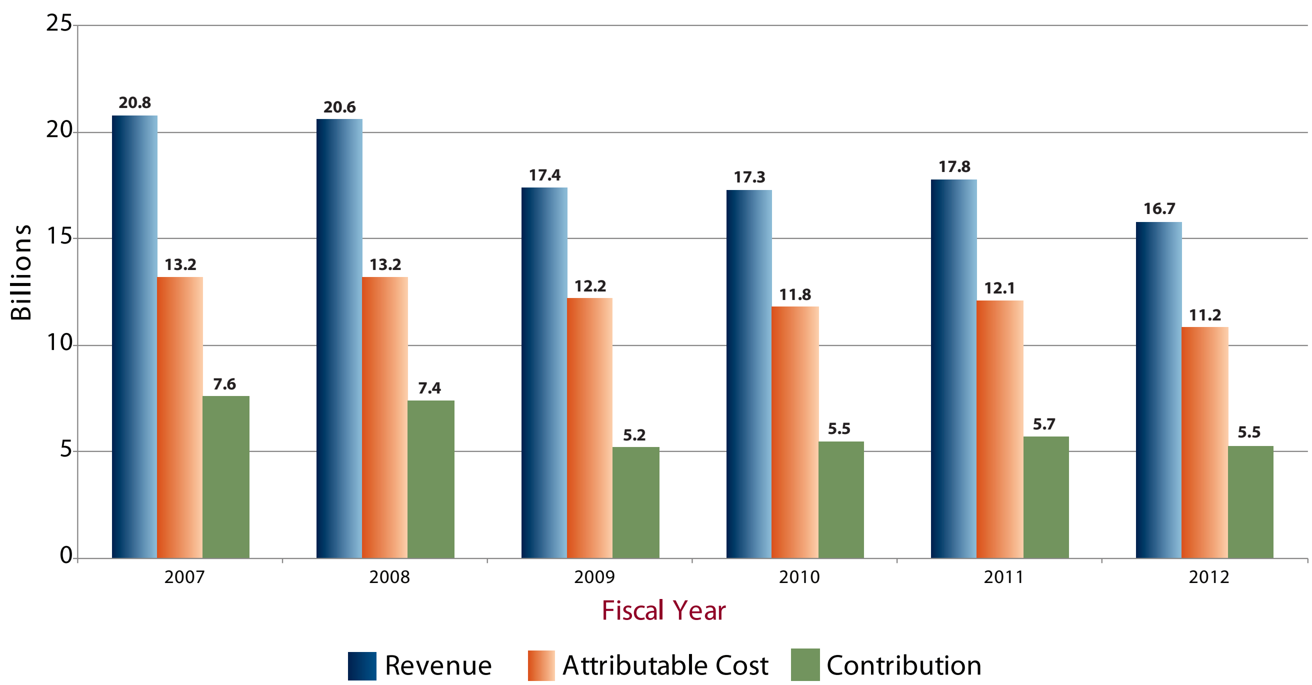
Table VII–16—Standard Mail Fiscal Year 2012 Volume, Revenue, Cost Contribution, and Cost Coverage by Product

	Volume (000)	Revenue ($000)	Attributable Cost ($000)	Contribution to Institutional Cost ($000)	Revenue Per Piece (Cents)	Cost Per Piece (Cents)	Unit Contribution (Cents)	Cost Coverage
High Density & Saturation Letters	5,563,559	770,882	346,973	423,908	13.86	6.24	7.62	222.2%
High Density & Saturation Flats & Parcels	11,770,275	1,955,823	900,140	1,055,683	16.62	7.65	8.97	217.3%
Carrier Route	9,119,946	2,249,836	1,720,605	529,231	24.67	18.87	5.80	130.8%
Letters	47,102,691	9,213,404	5,149,404	4,064,000	19.56	10.93	8.63	178.9%
Flats	5,939,635	2,233,730	2,761,670	(527,940)	37.61	46.50	-8.89	80.9%
Parcels	303,559	288,894	337,853	(48,959)	95.17	111.30	-16.13	85.5%
Inbound Intl. Negotiated Serv. Agreement Mail	1,345	702	148	554	52.21	11.01	41.19	474.0%
Total Standard Mail	79,801,009	16,713,271	11,216,793	5,496,477	20.94	14.06	6.89	149.0%

Source: PRC-ACR2012-LR1.

Figure VII–1 demonstrates the decreased contribution provided by Standard Mail in FY 2012.

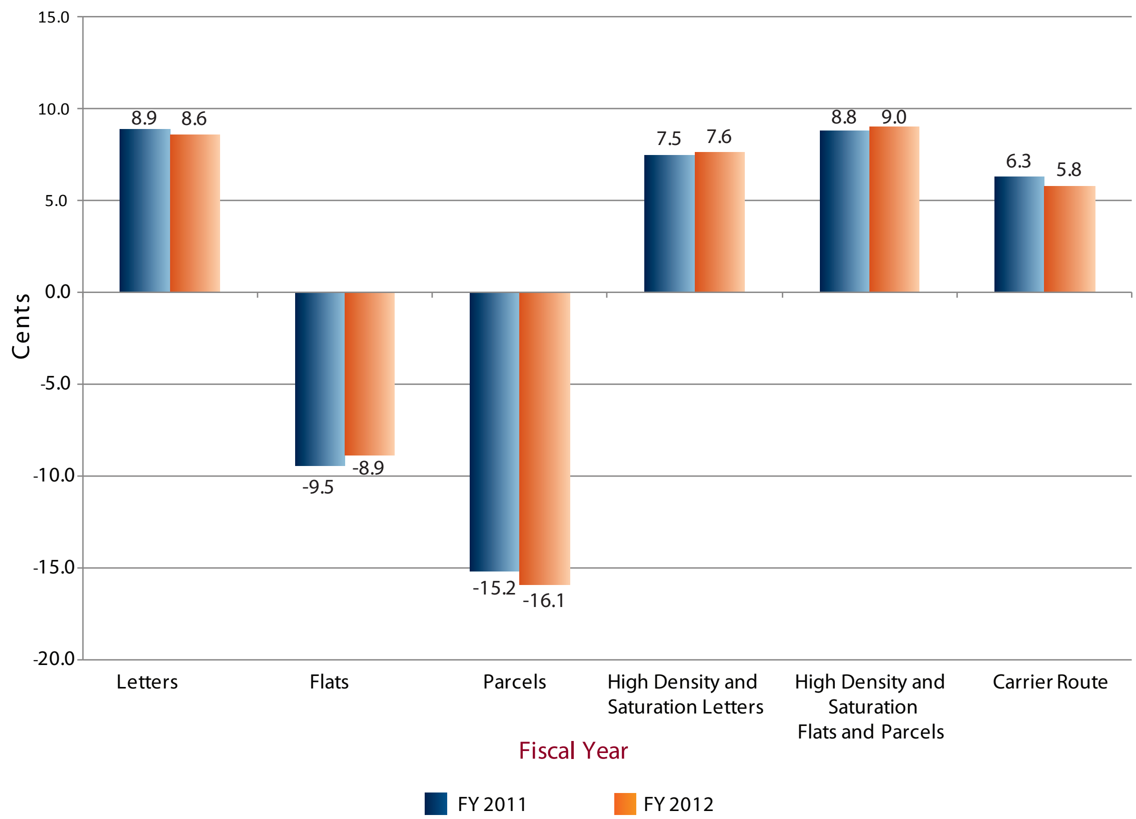
Figure VII–1—Standard Mail Trends



Source: 2007 ACD at 87, 2008, ACD at 59, 2009 ACD at 83, 2010 ACD at 102, 2011 ACD at 111, and Table VII-16.

Standard Mail as a class contributed $5.5 billion to institutional costs, but two products within the class did not cover attributable costs. Figure VII–2 shows the unit contribution of each Standard Mail product for FY 2011 and FY 2012. Figure VII–2 also demonstrates the increased unit contribution from Flats, High Density and Saturation Letters and High Density and Saturation Flats and Parcels compared to FY 2011 and the reduced contribution of the remaining products.

Figure VII–2—Unit Contribution by Standard Mail Product FY 2011 and FY 2012



Source: 2011 ACD at 112, and Table VII-16.

It is noteworthy that contribution decreased by $251 million. As in the case of First-Class Mail, the loss in volume accounts for much of the decreased contribution. In particular, the volume of Standard Letters decreased by 3.6 billion resulting in a reduction of about $425 million in contribution. As noted elsewhere, this impedes the ability of the Postal Service to cover its fixed costs.

Standard Mail Letters

In FY 2012, Standard Mail Letters had a cost coverage of 178.9 percent, and contributed $4.1 billion to institutional costs. This was a $425 million decrease in contribution compared to FY 2011. On a unit basis, the Letters product contributed 8.6 cents to the institutional costs of the Postal Service, a 2.5 percent decrease from FY 2011. Letter revenue per piece increased by 1.5 percent, while attributable cost per piece increased by 4.8 percent. Letter volume decreased by 7.1 percent, 3.6 billion pieces, compared with FY 2011.

Standard Mail Flats

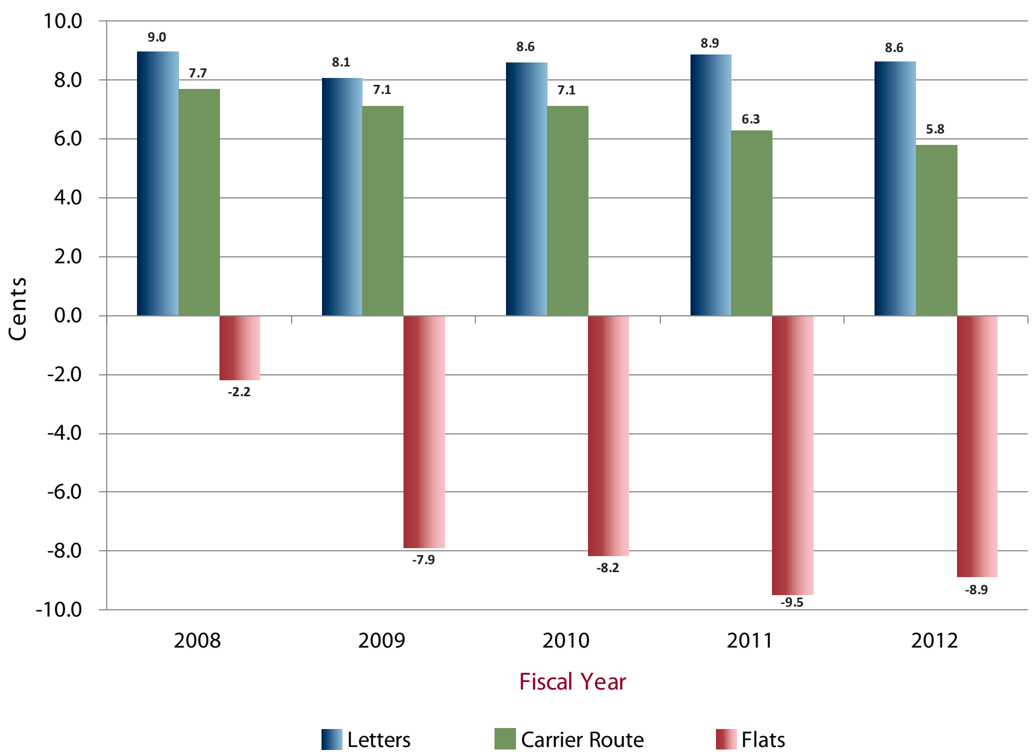
Cost coverage for Standard Mail Flats was 80.9 percent in FY 2012, a slight increase from its 79.5 percent cost coverage in FY 2011. Prior to FY 2012 the cost coverage on Flats decreased consistently each fiscal year since 2008, as shown in Table VII-17. Similarly, the difference in unit contribution between Standard Mail Flats and Standard Mail Letters, and Carrier Route increased from FY 2008 to FY 2011. The difference decreased in FY 2012. *See* Figure VII-3.

Table VII–17—Standard Mail Flats' Cost Coverage and Contribution FY 2008—FY 2012

	2008	2009	2010	2011	2012	Total
Cost Coverage	94.4%	82.3%	81.8%	79.5%	80.9%	—
Contribution	($217.83)	($615.57)	($576.99)	($643.19)	($527.94)	($2,581.53)

Source: 2008 ACD at 59, 2009 ACD at 83, 2010 ACD at 102, 2011 ACD at 112, and Table VII-16.

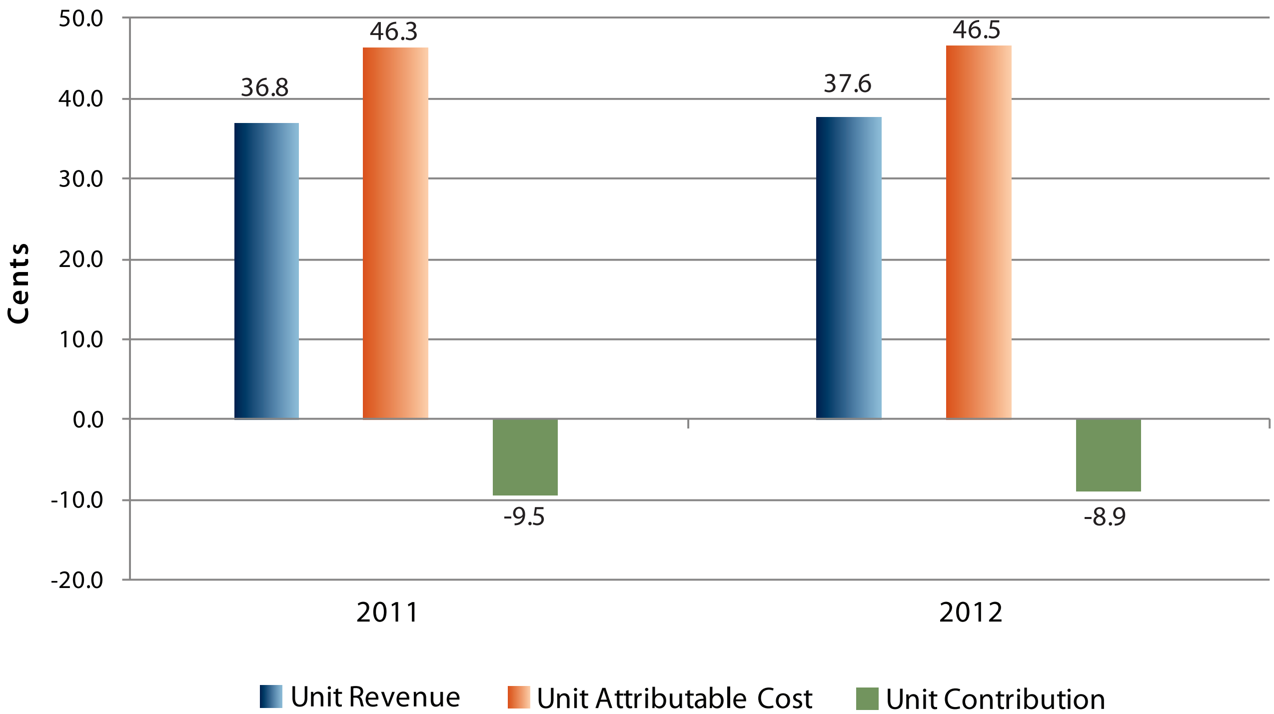
Figure VII–3—Unit Contribution for Standard Mail Letters, Flats, and Carrier Route



Source: PRC-ACD2012-LR3.

In FY 2012, unit revenues for Standard Mail Flats increased by 0.8 cents, while unit attributable costs increased by 0.2 cents. *See* Figure-VII–4.

Figure VII–4—Standard Mail Flats Unit Revenue, Unit Attributable Cost and Unit Contribution for FY 2011 and FY 2012



Source: 2011 ACD at 114, and Table VII-16.

In the FY 2010 ACD, the Commission determined that Standard Mail Flats prices in effect in FY 2010 did not comply with section 101(d) of title 39. Pursuant to section 3653(c), the Commission directed the Postal Service to increase the cost coverage of the Standard Mail Flats product through a combination of cost reductions and above-average price adjustments, consistent with the price cap requirements, until such time that revenues exceed attributable costs. 2010 ACD at 106. In addition, the Postal Service was directed to provide in its next ACR and market dominant price adjustment the following information: (1) a description of operational changes designed to reduce flats costs in the previous fiscal year and an estimation of the financial effect of such changes; (2) a description of all costing methodology or measurement improvements made in the previous fiscal year and estimated financial effects of such changes; (3) a statement summarizing the historical and current fiscal year subsidy of the Flats product; and, (4) the estimated timeline for phasing out the subsidy. Id. at 107.

The Postal Service appealed the Commission's FY 2010 ACD findings and directive to the United States Court of Appeals for the District of Columbia Circuit. On April 17, 2012, the United States Court of Appeals for the District of Columbia Circuit issued an opinion in *United States Postal Service v. Postal Regulatory Commission*, 676 F.3d

1105 (D.C. Cir. 2012). In its opinion, the Court rejected the Postal Service's contention that the Commission acted outside of the scope of its statutory authority by considering the general standards of section 101(d) in an annual compliance determination "at least in extreme circumstances". *Id*. at 1108. The Court remanded the case to the Commission "for a definition of the circumstances that trigger section 101(d)'s failsafe protection, and for an explanation of why the particular remedy imposed here is appropriate to ameliorate that extremity…." *Id*. at 1110. In response, the Commission issued Order No. 1427 clarifying that its analysis of the circumstances that would trigger section 101(d) depended on the totality of circumstances. Order No. 1427. at 4.

The Commission identified the following specific factors which, in the case of Standard Mail Flats, triggered section 101(d)'s protections: a significant and growing cost coverage shortfall, the duration of the shortfall over a significant period, evidence the shortfall is likely to increase further, a significant adverse impact on users of other products, failure of the Postal Service to address the shortfall and the failure of the Postal Service to take remedial steps. The Commission also stated that an extreme case may not apply if price increases would be counterproductive under the price cap or if cost reductions were not feasible. *Id*. at 9. The Commission affirmed that Flats present an "extreme case." The Commission explained further that additional factors could emerge in other cases that would support a finding of extreme circumstances requiring remedial action. *Id*. at 10. In addition, the Commission stated that it "does not interpret section 101(d) to require 'only 100% cost coverage, and nothing short of 100%' to satisfy the fair and equitable cost apportionment standard, provided an adequate explanation for a failure to improve cost coverages is offered." *Id*. at 14.

While the court case was pending, in its FY 2011 ACD, the Commission found that the rates and fees for Standard Mail Flats remained out of compliance and that Standard Mail prices continued to reflect an unfair and inequitable apportionment of the costs of postal operations to all Standard Mail users. 2011 ACD at 118-119. Shortly after the close of FY 2011, the Postal Service filed notice with the Commission announcing an above average increase of 2.209 percent for Standard Mail Flats. The Commission explained in its FY 2011 ACD that "[o]rdinarily, the Commission would consider the Postal Service's subsequent filing." However, because of the pendency of the litigation regarding the FY 2010 ACD, the Commission held action in this area in abeyance pending receipt of the Court's decision and did not require further remedial action. *Id*. at 16 and 119.

On September 21, 2012, the Commission issued an order confirming termination of the stay it had previously granted pending resolution of the Postal Service's appeal. The Commission directed that as part of its FY 2012 ACR the Postal Service should respond to the specific remedy adopted by the FY 2010 ACD.

Postal Service Response to ACD Directive

In its FY 2012 ACR, the Postal Service presents a three-year schedule of above-CPI price increases for the Flats product. FY 2012 ACR at 19. The Postal Service plans to increase Standard Flats prices by CPI multiplied by 1.05 in 2014, 2015 and 2016. The Postal Service notes two caveats regarding reasons why the schedule may not be achievable. First, it contends that the schedule is speculative, because it relies on numerous assumptions about future conditions. Second, it notes that only the Postal Service's Governors have the authority to change the prices of postal products and the Governors have not yet approved these proposed changes. *Id*. at 16.

The Postal Service contends that above-CPI price increases for the Flats product could impair the Postal Service's ability to enhance its revenue and contribution in the long run. It asserts that due to the rapid decline of Flats volume, using more of the Postal Service's limited cap-based pricing authority on higher than average increases for Flats could have a negative impact on contribution from Standard Mail in the future. *Id*. at 17-18. To support its claims, the Postal Service presents seven models prepared by Christensen Associates estimating contribution impacts for Standard Mail Flats and all other mail for different scenarios. *See* Library Reference USPS-FY12-43.

The Christensen Associates Report discusses the scenarios presented in the models and concludes that the models demonstrate that the relative volume trends for Standard Mail Flats and other Standard Mail can have a substantial effect on the total contribution obtained from Standard Mail under a given set of price increases. Specifically, it suggests that "more measured paces of price increases for Flats can provide greater contribution, compared to large near-term price increases above the cap, when the autonomous trend in Flats features a sharper decrease than that for other Standard Mail." Scenario Analysis for Standard Mail Contribution at 9.

In its FY 2012 ACR filing, the Postal Service was not responsive to the Commission's FY 2010 ACD directive. It did not provide: (1) a description of operational changes designed to reduce flats costs and an estimate of the financial effect of such changes; (2) a description of all costing methodology or measurement improvements made in the previous fiscal year and an estimate of the financial effects of such changes; or (3) a statement summarizing the historical and fiscal year subsidy of the Flats product; and (4) an estimated timeline for phasing out this subsidy.

However in its response to CHIR No. 1, question 1, the Postal Service identified eight steps designed to make the processing of Standard Mail Flats more efficient: (1) FSS Scorecard; (2) moving mail up the ladder[21] ; (3) mail preparation; (4) mail entry; (5) bundle operation; (6) Service Performance Diagnostics Tool; (7) visibility; and (8) other future enhancements. For a discussion of each of these initiatives, refer to the Postal Service's response to CHIR No. 1, question 1.

The Postal Service did not provide the financial effect of the operational changes identified above. In its response to CHIR No. 1, question 1, it states that it did not perform any analysis to isolate the cost savings resulting from the above initiatives because it may not be possible to isolate the cost savings from individual initiatives. The Postal Service also referred to its response to CHIR No. 1, question 7(b), in Docket No. ACR2011, filed on February 8, 2011. In that response, the Postal Service noted that its cost models are not designed to isolate reductions in manual handling costs, particularly given the fact that mail volumes, mail processing operations, mail classifications, and equipment sets change from year to year. The Postal Service added that while manual handling costs are captured in IOCS tallies and in the flats cost models (to the extent that the data are available in inputs that the models rely upon), the costs cannot be separated out.

In response to CHIR No. 2, question 2, the Postal Service identified three costing methodology changes that affected Standard Mail Flats costs in FY 2012: (1) Proposal Two, Docket No. RM2012-5; (2) Proposal Five, Docket

[21] The Postal Service explains that "moving mail up the ladder" refers to the aim of increased processing on automated equipment and the corresponding decrease of manual processing. *Id*. at 4.

No. RM2012-5; and (3) Proposal Seven, Docket No. RM2012-7. The three modifications added $6.4 million in attributable cost to Standard Mail Flats.

Additionally, the Postal Service provided the historical and current fiscal year subsidy of the Flats product. However, the Postal Service did not provide a timeline for phasing out the subsidy because it contends that it is difficult to predict when the shortfall for Standard Mail Flats will be phased out. The Postal Service notes that "given the product's low cost coverage and the limitations of the price cap system, the shortfall is unlikely to be eliminated by the end of 2016." CHIR No. 1, question 2(c).

Comments

Comments generally address four areas: (1) the Christensen Associates Standard Mail Risk Analysis; (2) the Valpak Contribution Model; (3) the intra-class cross-subsidy; and (4) recommendations for Commission action.

The Christensen Associates Standard Mail Risk Analysis (Christensen Analysis)

Christensen Associates presents seven models to illustrate its risk analysis. Each of the models uses own-price elasticity of -0.6 for Standard Mail Flats and -0.4 for all other Standard Mail. These values assume that Flats demand is somewhat more price elastic than other Standard Mail products. Each model represents a hypothetical price change scenario constrained by an assumed price cap and computes the contribution for Standard Mail in response to price-induced volume changes. The scenarios also explore the effect of hypothetical price changes on contribution using different assumptions about the variability of cost. Some of the scenarios assume the same secular volume trend for Flats and other categories of Standard Mail, while others explore the possibility that the volume for Flats and all other Standard Mail trend independently, with Flats volume having a more significant downward trend.

The Public Representative, Valpak, Pitney Bowes, and the American Catalog Mailers Association (ACMA) critique the Christensen Analysis presented by the Postal Service. The Public Representative recommends the use of more realistic price elasticity assumptions, an above-average limited price-cap increase for a longer period of time, and the correction of certain methodological inaccuracies. PR Comments at 33-39. Valpak expresses concern that the Christensen Analysis hypothesizes possibilities which support the Postal Service's existing pricing choices but ignores the certainty of losses from Standard Flats. Valpak Comments at 63. Valpak uses the Christensen model's assumptions to demonstrate that greater contribution could be obtained by imposing more aggressive price increases on Standard Flats. *Id*. at 59-80. The Public Representative reaches a similar conclusion by changing the price elasticity assumptions in the model to the Postal Service's own econometric elasticity results for both Standard Flats and All Other Standard Mail. PR Comments at 35-36. Pitney Bowes also contends that the use of more accurate assumptions reveals that "smaller price increases on the higher-contribution products – offset by larger increases on lower-contribution products – improves Postal Service finances." Pitney Bowes Comments at 3.

ACMA argues that there is a high likelihood that the Christensen Analysis understates the risks of adverse impacts from large rate increases for Standard Mail Flats. It suggests that the price-elasticity of demand for Flats assumed in the Christensen model should be higher in absolute value. It also contends that the models should be adjusted to reflect a lower volume elasticity of attributable cost to account for the presence of excess capacity. ACMA provides a cost index that purports to show that the cost of excess capacity is being attributed to Flats. It suggests that long-run marginal cost, developed during a period of excess capacity is excessive and is not a valid measure of the resources that are absorbed by the products in question. ACMA Comments at 18. ACMA notes that the Christensen Analysis does not discuss the possibility of a multiplier. ACMA asserts that an increase in catalog volume would be expected to cause an increase in parcels and First-Class letters. *Id*. at 19-21.

Valpak and the Public Representative criticize ACMA's proposed cost index as well as its assertions that the Christensen model understates the negative effects of increasing prices for Standard Flats. Valpak Reply Comments at 4-7, 12-16; PR Reply Comments at 23-25, 27-31. Valpak contends that ACMA's argument about the higher price-elasticity of demand for Flats is not supported by any data. Valpak Reply Comments at 4-6. Valpak also expresses reservations regarding ACMA's multiplier effect argument. *Id*. at 6-7. First, Valpak notes that the vast majority of parcels are still delivered by FedEx and UPS. *Id*. It contends that any package fulfillment benefit from catalog purchases, primarily benefits FedEx and UPS. Second, Valpak expresses doubts that any significant First-Class letter volume is generated, as most catalog transactions are done electronically. *Id*.

Valpak Contribution Model

Valpak offers its own Standard Mail contribution model to demonstrate the inadequacy of the Postal Service's rationale for failing to implement meaningful above-average price increases for Standard Mail Flats. Valpak Comments at 80-107.

The Valpak model computes the maximum "allowable revenue" by increasing last year's total revenue for Standard Mail by the CPI price cap. For each product, it provides a schedule showing the additional contribution per dollar of this allowable revenue that can be expected to result from a unit price increase. To compute the change in contribution from a unit price increase, the model uses the elasticity estimates submitted by the Postal Service on January 22, 2013. Unlike the Christensen model, the Valpak model does not incorporate estimates of secular volume trends.

The Valpak model allows the user to compare the schedules for all the Standard Mail products. To derive the prices that maximize contribution, marginal price increases are given to products that yield the greatest contribution per dollar of allowable revenue until some other product offers more contribution from a marginal increase in price. At the optimal combination of price increases, the additional contribution per dollar of allowable revenue from each product should be equal at the margin.

Valpak reports that by applying this procedure, the Valpak model shows that contribution would be maximized if Standard Flats prices are increased by approximately 4 percent and Standard Parcels prices are increased by approximately 8 percent. *Id*. at 101.

The Postal Service and ACMA both question the value of Valpak's contribution model. The Postal Service contends that Valpak's Standard Mail contribution model is not a useful tool for determining optimal Standard Mail prices because it does not take into account the autonomous volume decline of Standard Mail Flats. Postal Service Reply Comments at 5-14. In addition, the Postal Service objects to Valpak's assumption that the aggregate price elasticities from the Postal Service's market dominant demand equations are applicable to each Standard Mail product within the aggregate. *Id*. ACMA asserts that, due largely to the attribution of excess capacity costs, an unknown proportion of reported costs are not volume variable, and therefore are unsuitable for evaluating cost coverages in the Valpak model. ACMA Reply Comments at 5-7. ACMA also notes that the Valpak model does not include exogenous volume trends, omits cross elasticities and relies on commercial elasticities, using the same elasticity for commercial and nonprofit Letters and Flats. *Id*. at 3-12.

Intra-class Cross-subsidy

Valpak also argues that the Postal Service is giving unreasonable preference to mailers who use Flats, as opposed to mailers such as Valpak that send letters. Valpak Comments at 117. It contends that the Postal Service is picking winners and losers among advertisers, thereby creating an unlevel playing field. *Id*.

As it did in the FY 2011 ACR proceeding, ACMA challenges the premise that the Standard Mail Flats product is suitable for a cross-subsidy test. ACMA Comments at 2-5. It argues that the Standard Flats product is not aligned with markets or the way mailers of catalogs use Standard Flats in conjunction with other Standard Mail products, such as Carrier Route or High Density flats categories. *Id.* at 3-4. The Direct Marketing Association (DMA) expresses similar sentiments. It urges the Commission to examine Standard Mail Flats as the residual part of a larger Carrier Route mailing. DMA Comments at 1-2. DMA also insists that the Commission must base any pricing recommendations or directives for FY 2013 on a complete understanding and incorporation of the Postal Service's accelerated cost cutting efforts. *Id*.

Recommendations for Commission Action

Valpak and the Public Representative assert that the Postal Service is not doing enough to eliminate the subsidy. Valpak contends that the steps that the Postal Service has taken are inadequate. *Id*. at 39. It claims that if the Postal Service does not pick up the pace of improvement in cost coverage, Flats will not reach full cost coverage until FY 2026. Valpak Comments at 39. Valpak recommends annual increases in the range of CPI plus 5 percent. *Id*. at 48. The Public Representative recommends slightly lower increases than Valpak, with above-cap price increases of 2-3 percent. PR Comments at 38-39. Additionally, the Public Representative asserts that it is unlikely that cost improvements identified by the Postal Service in this year's ACR will eliminate the shortfall. *Id*. The Public Representative recommends that the Commission require the Postal Service to make a greater effort to reduce the costs of Standard Flats and report the effect of those efforts in next year's ACR. PR Comments at 32.

The Postal Service does not believe that the criticisms or alternative pricing scenarios offered by the Public Representative and Valpak meaningfully undercut the Postal Service's arguments against mechanically raising Standard Mail Flats prices above the cap. Postal Service Reply Comments at 6. The Postal Service "urges the

Commission to leave its FY 2010 ACD order unchanged, and to allow the Postal Service to proceed with its proposed three-year schedule of above-average price increases." *Id.*

ACMA argues that among the "totality of circumstances" that the Commission is obligated to consider in determining compliance of Standard Mail Flats are other circumstances, such as the costs of excess capacity, the likelihood that the Christensen Analysis understates the risks of adverse impacts from large rate increases for Standard Mail Flats, and the value and cultural significance of catalogues. ACMA Comments at 24-25.

Valpak opposes ACMA's critique of the evaluation of Standard Flats as a product, ACMA's assertions that excess capacity is responsible for Standard Flats' low cost coverage, ACMA's attempt to use short-run marginal costs as a justification for not raising Standard Flats prices, and ACMA's claims that the value of catalogue mailings warrant recognition in postal rates. Valpak Reply Comments at 7-11, 17-33.

PostCom suggests that organic changes within the industry favor taking a wait-and-see approach to Flats prices. PostCom Comments at 2. It states that due to improvements in price, co-mailing, and co-palletization a substantial portion of Flats volume (including catalogs) has migrated to Carrier Route. *Id.* The current proposed prices are expected to continue that shift. *Id.* at 1-3. It states that regardless of whether a worksharing relationship between Flats and Carrier Route exists, the three factors enumerated above will drive volume away from Flats to Carrier Route pieces. *Id.* at 4. It recommends that the Commission direct the Postal Service to track this migration, study its causes and effects, and only take action once a clearer picture of mailing patterns emerges. *Id.* at 4-5.

Commission Analysis

In its review of Standard Flats, the Commission first considers the factors that it identified as creating an "extreme case" triggering section 101(d)'s protections in the FY 2010 ACD. Next, the Commission discusses other relevant factors raised by commenters.

While a significant cost coverage shortfall still exists in FY 2012, it is not growing. The above-average price increase for Flats in Docket No. R2012-3, a below CPI-U increase in unit cost and a significant drop in volume resulted in a reduction in contribution loss compared with FY 2011. Although losses from Standard Mail Flats are continuing, the amount of loss incurred in FY 2012 is less than the FY 2011 loss.

There is no evidence that the cost coverage shortfall is likely to grow. The Postal Service plans to adjust prices for Flats slightly above CPI through 2016. If the Postal Service can keep cost increases from outpacing price increases, the shortfall will decrease. There is reason to believe that the Postal Service can contain costs. The unit costs of Flats increased at or below CPI since FY 2010. In FY 2012, unit cost increased by 0.05 percent, well below the change in CPI-U .[22]

However, the Commission remains concerned about the adverse impact on users of other products. Below cost rates for Flats may give a competitive advantage to users of Flats over other retailers. The unit contribution gap

[22] The CPI-U for FY 2012 is 2.07 percent.

between Letters and Flats, and between Carrier Route and Flats have decreased from FY 2011. The gaps between Letters and Flats decreased from 18.3 cents in FY 2011 to 17.5 cents in FY 2012. Similarly, the gap between Carrier Route and Flats decreased from 15.8 cents in FY 2011 to 14.7 cents in FY 2012.

In response to the Commission's FY 2010 directive, the Postal Service has taken steps to address the cost coverage shortfall. In FY 2012, the Postal Service made improvements with regard to cost and revenue. Nonetheless, several commenters argue that the Postal Service has not done enough to curb the shortfall and that the steps it has taken are inadequate to close the cost coverage gap in a reasonable time. The Commission finds that the steps taken thus far have been helpful but it is concerned that the Postal Service has not quantified the cost savings from operational changes designed to reduce Flats costs.[23] Consequently, the Commission cannot properly assess the likely rate of improvement in the cost coverage shortfall.

It is apparent that the Postal Service has taken remedial steps to address the cost coverage shortfall. If implemented, the schedule of price increases presented by the Postal Service coupled with cost changes below CPI-U would ensure continued improvement.

ACMA asserts that due to excess capacity, the Postal Service's long-run marginal cost of Flats overstate the resources that are used by Flats. However, it has not offered a comprehensive analysis to quantify the impact of excess capacity on Flats attributable cost. As it explained in the FY 2010 ACD, the Commission finds that short-run marginal cost is not an appropriate basis for evaluating the adequacy of product revenues.[24]

The Commission reviewed the Christensen Analysis and the Valpak model. These models rely on assumptions about the own-price elasticity of demand of Standard Mail products. The usefulness of both models would be significantly improved if estimates of own-price elasticity of demand were available by product. *Given the serious implications of the pricing of Standard Mail Flats, the Commission recommends that the Postal Service derive elasticity estimates to provide for a more realistic assessment of the impact of price changes on contribution.*

Some commenters suggest that the Commission should consider the possible effect of price changes for Flats on the volume of other products. In particular, they assert the Commission should take into account that Carrier Route and Flats are complements and that catalogs, which are often sent as Flats, have a multiplier effect. While the Commission is mindful of the possible relationship between Flats and other products, there is insufficient information to identify with any reliability what types of mail can be deemed "responsible" for other items in the mailstream.

The commenters also express divergent views as to what steps the Commission should take regarding Standard Mail Flats. In response, the Postal Service asserts "some degree of contribution risk is created by raising Flats prices too quickly in the near-term" and urges the Commission to "leave its FY 2010 ACD order unchanged, and to allow the Postal Service to proceed with its proposed three-year schedule of above-average price increases." Postal Service Reply Comments at 6. *The Commission finds that the Postal Service has begun to make progress towards addressing the issues raised by the Commission in the FY 2010 ACD. The approach advocated by the Postal Service does not require changes to the Commission's FY 2010 ACD directive.*

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23 Generally, cost savings programs or initiatives target one or more specific activities to produce cost savings. These programs should have specific measurable targets by which the benefits of the program can be evaluated.

24 2010 ACD at 92-93.

Standard Mail Parcels

The Parcels product did not produce sufficient revenues to cover its attributable costs in FY 2012. The Parcels product had an 85.5 percent cost coverage and had a net loss of $49.0 million. This is $62.7 million less than the FY 2011 loss of $111.7 million, primarily due to the transfer of a portion of the Parcels product to the competitive product list. Unit contribution decreased from negative 15.2 cents in FY 2011 to negative 16.1 cents in FY 2012. Both unit attributable costs and unit revenues increased, 6.4 percent and 6.5 percent, respectively.

In Docket No. R2013-1, the Postal Service proposed and the Commission approved an above-average increase of 3.081 percent. This is the fifth consecutive above-average price increase for the Parcels product.

In Docket No. MC2010-36, the Postal Service requested to change the name of the Standard Mail Not Flat-Machinable/Parcels product to Standard Parcels, and to divide it into two categories: Marketing Parcels and Fulfillment Parcels. Additionally, the Postal Service requested a transfer of the market dominant commercial Standard Mail Fulfillment Parcels to the competitive product list in the Mail Classification Schedule (MCS). These changes became effective on January 22, 2012 and are discussed further in Chapter VIII.

In FY 2012, the revenue generated from Standard Mail Parcels was not sufficient to recover the attributable cost of the product or make a contribution to institutional costs. *The Commission finds that the Postal Service's approach to ending the intra-class cross-subsidy is appropriate and it should continue using its pricing flexibility to do so. The Commission also encourages the Postal Service to reduce Parcels costs to close the cost coverage gap.*

High Density and Saturations Letters

In FY 2012, the High Density and Saturation Letters product had a cost coverage of 222.2 percent, and contributed 7.6 cents per piece to institutional costs. The product contributed a total of $423.9 million to institutional costs, with commercial pieces contributing $412.7 million and nonprofit pieces contributing $11.3 million.

Valpak argues that the pricing of the High Density and Saturation Letters product is arbitrary and capricious, in violation of 39 U.S.C. 3622; fails to apportion the costs of Standard Mail fairly in violation of 39 U.S.C. 101(d); and unfairly discriminates against High Density/Saturation Letters, in violation of 39 U.S.C. 403(c). Valpak Comments at 121-122. Valpak urges the Commission to find High Density/Saturation Letter pricing illegal, and to enter a remedial order to roll back the January 27, 2013 price increases for this product. *Id.* at 120.

Valpak contends that there is no rational basis for the Postal Service's pricing decisions regarding the High Density and Saturation Letters product. It asserts that the Postal Service's pricing is not cost-based because the unit revenue of the High Density and Saturation Letters product increased more since FY 2008 than that of Flats and High Density and Saturation Flats and Parcels even though the High Density and Saturation Letters product is the only Standard Mail product that had a unit cost decrease over the same period. *Id.* at 111-113. Valpak also asserts that the pricing of the High Density and Saturation Letters product is neither demand-based nor an attempt by the Postal Service to equalize cost coverages for the Standard Mail products. *Id.* at 107-111, 114-115. To support its assertions, Valpak notes that the Postal Service gave high elasticity products such as the High Density and Saturation Letters product higher increases than low elasticity products. *Id.* Valpak also contends that differences in cost coverage between Standard Mail products cannot be explained by content of the mail since all Standard Mail products are primarily used for advertising. *Id.* at 115.

The Commission examined cost coverages, unit costs, unit revenues, unit contributions and other relevant information for the Standard Mail products. The Postal Service is accorded pricing flexibility under title 39. Pricing of market dominant products under the PAEA is guided by various objectives and factors. Postal Service pricing is not limited to a cost based or demand based approach. In the past, the Postal Service has used its pricing flexibility to offer incentives to mailers of High Density and Saturation Letters. For example, in FY 2012, the Postal Service offered mailers of this product discounts on incremental volume through its Saturation and High Density Mail Incentive Program. Incentives of this kind have the effect of mitigating price increases. *The Commission finds that the pricing of High Density and Saturation Letters is reasonable.*

High Density and Saturation Flats and Parcels

Revenues for the High Density and Saturation Flats/Parcels product exceeded its attributable costs, which resulted in cost coverage of 217.3 percent in FY 2012. The product as a whole contributed $1.1 billion to the institutional cost of the Postal Service. Table VII-18 shows the volume and contribution distribution of High Density and Saturation Flats and High Density and Saturation Parcels.

Table VII–18—FY 2012 High Density and Saturation Flats and Parcels
Volume and Contribution by Shape (000)

	Flats	Parcels	Total
Volume	11,769,382	893	11,770,275
Contribution	$1,055,830	$(148)	$1,055,683

Source: PRC-ACR2012-LR1.

Table VII-18 shows that Flats comprise more than 99 percent of the product contributing $1.1 billion. In contrast, the Parcel portion shows a loss of $148 thousand.

In Docket No. R2013-1, the Postal Service proposed and the Commission approved below average price increases for the High Density and Saturation Flats/Parcels product. *See* PRC-R2013-1-LR6.

Carrier Route

In FY 2012, revenues from the Standard Mail Carrier Route product (which includes letters, flats, and parcels) exceeded the product's attributable costs with a cost coverage of 130.8 percent. The Carrier Route product contributed $529 million toward the Postal Service's institutional costs. In FY 2012 unit attributable costs increased by 7.3 percent, while unit revenues increased by 3.4 percent. The nonprofit component of the Carrier Route product did not cover its attributable costs, which resulted in a negative contribution of $19.2 million.

Worksharing

Table VII-19 shows the passthroughs by shape for dropship Carrier Route, High Density, and Saturation categories. All of the passthroughs are less than 100 percent.

Table VII—19—Standard Mail Carrier Route, High Density, and Saturation by Shape (Commercial and Nonprofit) Workshare Discounts and Benchmarks

Type of Worksharing (Benchmark)	Year-End Discount (cents)	Unit Cost Avoidance (cents)	Passthrough
Presorting (cents/piece)			
High Density Letters[1] (Carrier Route Letters)	7.2	27.4	26.3%
High Density Flats[1] (Carrier Route Flats)	4.7	5.4	87.0%
High Density Parcels[1] (Carrier Route Parcels)	13.9	141.0	9.9%
DropShip (cents/pound)			
DNDC Letters (Origin Letters)	16.1	28.4	56.7%
DSCF Letters (Origin Letters)	20.9	35.5	58.9%
DNDC Flats (Origin Flats)	16.1	20.6	78.2%
DSCF Flats (Origin Flats)	20.9	23.6	88.6%
DDU Flats (Origin Flats)	25.2	28.3	89.0%
DNDC Parcels (Origin Parcels)	22.4	151.3	14.8%
DSCF Parcels (Origin Parcels)	46.2	199.7	23.1%
DDU Parcels (Origin Parcels)	64.1	219.6	29.2%

[1] For this category, the discount for commercial and nonprofit differs. For the nonprofit discount and passthrough, *see* Table VII-23.

Source: PRC-ACR2012-LR3.

Table VII-20, Table VII-21, and Table VII-22 show the passthroughs for the remaining products: Letters, Flats, and Parcels. The discounts for twelve workshare categories exceed avoided cost. In its discussion of discounts that exceed avoided costs, the Commission follows the order of the tables as closely as practicable. Accordingly, the Commission first discusses Letters, then Flats, and finally the Parcels product.

Some nonprofit workshare discounts differ from the corresponding commercial workshare discounts. This is discussed in the subsection below entitled Commercial and Nonprofit Workshare discounts.

Table VII—20—Standard Mail Letters and Flats (Commercial and Nonprofit) Presorting/Barcoding Workshare Discounts and Benchmarks

Type of Worksharing (Benchmark)	Year-End Discount (cents)	Unit Cost Avoidance (cents)	Passthrough
Standard Mail Letters			
Standard Mail Automation Letters			
Presorting (cents/piece)			
Automation AADC Letters (Automation Mixed AADC Letters)	1.6	2.1	76.2%
Automation 3-Digit Letters (Automation AADC Letters)	0.2	0.4	50.0%
Automation 5-Digit Letters (Automation 3-Digit Letters)	1.8	2.0	90.0%
Barcoding (cents/piece)			
Automation Mixed AADC Letters (Non-automation Machinable Mixed ADC Letters)	0.3	(0.3)	-100.0%
Standard Mail Non-automation Letters			
Presorting (cents/piece)			
Non-automation AADC Machinable Letters (Non-automation Mixed AADC Machinable Letters)	1.6	1.8	88.9%
Non-automation ADC Non-machinable Letters (Non-automation Mixed ADC Non-machinable Letters)	9.7	8.0	121.3%
Non-automation 3-Digit Non-machinable Letters (Non-automation ADC Non-machinable Letters)	3.9	2.7	144.4%
Non-automation 5-Digit Non-machinable Letters (Non-automation 3-Digit Non-machinable Letters)	9.3	7.7	120.8%
Standard Mail Flats			
Standard Mail Automation Flats			
Presorting (dollars/piece)			
Automation ADC Flats (Automation Mixed ADC Flats)	1.0	2.2	45.5%
Automation 3-Digit Flats (Automation ADC Flats)	5.6	5.9	94.9%
Automation 5-Digit Flats[1] (Automation 3-Digit Flats)	8.5	8.7	97.7%
Barcoding (cents/piece)			
Automation ADC Flats (Automation Mixed ADC Flats)	5.7	4.5	126.7%
Standard Mail—Non-automation Flats			
Presorting (cents/piece)			
Non-automation ADC Flats (Non-automation Mixed ADC Flats)	3.3	5.9	55.9%
Non-automation 3-Digit Flats[1] (Non-automation ADC Flats)	5.8	6.1	95.1%
Non-automation 5-Digit Flats[1] (Non-automation 3-Digit Flats)	8.2	5.8	141.4%

Source: PRC-ACR2012-LR3.

[1] For this category, the discount for commercial and nonprofit differs. For the nonprofit discount and passthrough, *see* Table VII-23.

Table VII—21—Standard Mail Parcels (Commercial and Nonprofit) Presorting/Barcoding Workshare Discounts and Benchmarks

Type of Worksharing (Benchmark)	Year-End Discount (cents)	Unit Cost Avoidance (cents)	Passthrough
Nonprofit Standard Mail Parcels[1]			
Presorting (cents/piece)			
NDC Machinable Parcels (Mixed NDC Machinable Parcels)	36.9	53.6	68.8%
5-Digit Machinable Parcels (NDC Machinable Parcels)	25.0	55.0	45.5%
NDC Irregular Parcels (Mixed NDC Irregular Parcels)	36.9	15.2	242.8%
SCF Irregular Parcels (NDC Irregular Parcels)	34.4	34.6	99.4%
5-Digit Irregular Parcels (SCF Irregular Parcels)	2.5	46.5	5.4%
Pre-barcoding (cents/piece)[2]			
Mixed NDC Machinable Barcoded Parcels[3] (Mixed NDC Machinable Non-barcoded Parcels)	6.4	3.9	164.1%
Mixed NDC Irregular Barcoded Parcels[3] (Mixed NDC Irregular Non-barcoded Parcels)	6.4	3.9	164.1%
Standard Mail Marketing Parcels			
Presorting (cents/piece)			
NDC Marketing Parcels[4] (Mixed NDC Marketing Parcels)	41.5	30.8	134.7%
SCF Marketing Parcels[4] (NDC Marketing Parcels)	37.2	27.5	135.3%
5-Digit Marketing Parcels[4] (SCF Marketing Parcels)	2.4	45.4	5.3%
Barcoding (cents/piece)[2]			
Mixed NDC Barcoded Marketing Parcels[3] (Mixed NDC Non-barcoded Marketing Parcels)	6.4	3.9	164.1%

Source: PRC-ACR2012-LR3.

[1] On January 22, 2012, the Postal Service transferred Commercial Standard Mail parcels to the Competitive Product list.
[2] The Postal Service charges a surcharge for non-barcoded pieces.
[3] The Postal Service Standard Mail Parcel mail processing cost model does not estimate costs separately for barcoded and non-barcoded pieces. The Postal Service uses a barcoding avoidable cost for BPM as a proxy. *See* Table VII-27, barcoding workshare discounts.
[4] For this category, the discount for commercial and nonprofit differ. For the nonprofit discount and passthrough, *see* Table VII-23.

Table VII—22—Standard Mail Letters, Flats, and Parcels Dropship Discounts and Benchmarks

Type of Worksharing (Benchmark)	Year-End Discount (cents)	Unit Cost Avoidance (cents)	Passthrough
Standard Mail Letters			
Drop Ship (cents/pound)			
DNDC Letters (Origin Letters)	16.1	28.4	56.7%
DSCF Letters (Origin Letters)	20.9	35.5	58.9%
Standard Mail Flats			
Drop Ship (cents/pound)			
DNDC Flats (Origin Flats)	16.1	20.6	78.2%
DSCF Flats (Origin Flats)	20.9	23.6	88.6%
Standard Mail Machinable Parcels			
Drop Ship (cents/pound)			
DNDC Machinable Parcels (Origin Machinable Parcels)	22.4	151.3	14.8%
DSCF Machinable Parcels (Origin Machinable Parcels)	46.2	199.7	23.1%
DDU Machinable Parcels (Origin Machinable Parcels)	64.1	219.6	29.2%
Standard Mail Marketing Parcels			
Drop Ship (cents/pound)			
DNDC Marketing Parcels (Origin Marketing Parcels)	22.4	151.3	14.8%
DSCF Marketing Parcels (Origin Marketing Parcels)	46.2	199.7	23.1%
DDU Marketing Parcels (Origin Marketing Parcels)	64.1	219.6	29.2%
Standard Mail Irregular Parcels			
Drop Ship (cents/pound)			
DNDC Irregular Parcels (Origin Irregular Parcels)	22.4	151.3	14.8%
DSCF Irregular Parcels (Origin Irregular Parcels)	46.2	199.7	23.1%
DDU Irregular Parcels (Origin Irregular Parcels)	64.1	219.6	29.2%

Source: PRC-ACR2012-LR3.

Letters

Four discounts for Standard Mail Letters exceeded avoided cost in FY 2012: (1) non-automation ADC non-machinable letters; (2) non-automation 3-Digit non-machinable letters; (3) non-automation 5-Digit non-machinable letters; and (4) automation mixed AADC letters.

The Postal Service justifies the first three of these passthroughs by citing the exception granted in 39 U.S.C. 3622(e)(2)(B). The Postal Service notes that it intends to reduce these discounts until the discounts equal their avoided costs. It does not explain the nature or extent of the rate shock higher passthroughs would cause. *The Commission finds that the Postal Service has not demonstrated that these excessive discounts qualify for the exception cited. Accordingly, the Postal Service should either align the discounts with avoided cost when it files its next general market dominant price adjustment, or adequately support an applicable statutory exception.*

One worksharing category is problematic; the passthrough for automation mixed AADC letters is negative. The negative avoided cost differential (-0.3¢) is the result of the Postal Service's estimated cost for an automation mixed AADC letter exceeding the estimated cost for a non-automation machinable mixed AADC letter. Automation mixed AADC letters should be less costly than non-automation machinable mixed AADC letters. Thus, the Postal Service concludes that the costs are anomalous. 2012 ACR at 21 The Commission agrees. *For this reason, the Commission cannot determine whether the discount is consistent with section 3622(e).*

In several previous ACDs, the avoided cost estimate between automation and non-automation mixed AADC machinable letters was negative. However, the Commission approved a modified version of Proposal Nine in Docket No. RM2011-5, that more accurately reflects avoided cost which resulted in a positive estimate for this avoided cost in FY 2011. However, in FY 2012, the avoided cost estimate is once again negative. The Postal Service explains that this anomalous result stems from updating the model approved in Docket No. RM2012-2 Proposal 17 with FY 2012 productivity estimates. Response to CHIR No.4, question 6. The Postal Service explains that ISS productivities increased by 112 percent, thereby reducing the cost of applying a barcode to a mixed ADC non-automation machinable piece, while at the same time Outgoing BCS secondary productivity dropped 30 percent, thereby increasing the cost of sorting automation mixed AADC pieces. 2012 ACR at 21. *The Postal Service should reexamine the anomaly to better understand the costs associated with these workshare categories.*

Flats

Two discounts for Standard Mail Flats exceeded their avoided cost in FY 2012: the pre-barcoding discount for automation mixed ADC flats and the presort discount for 5-Digit non-automation flats.

The Postal Service justifies the excessive pre-barcoding discount for automation mixed ADC flats under section 3622(e)(2)(D), *i.e*., a reduction would impede operational efficiency. In previous ACRs the Postal Service explained that the excessive discount is necessary to encourage pre-barcoding of flats as a way to support the implementation of the Flats Sequencing System (FSS) program. Since the Postal Service's deployment of FSS machines has just been completed, there continues to be a need for a pre-barcoding incentive. In FY 2011, the Postal Service reduced the discount by 0.5 cents. In Docket No. R2013-1, the Postal Service proposed and the Commission approved an additional 0.2 cent reduction of the discount. The Postal Service notes its intention to continue to phase this discount out over time. 2012 ACR at 22. *The Commission finds the pricing of this discount justified.*

In Docket No. R2012-3, the presort discount for 5-Digit non-automation flats was set at its avoided cost. However, a decrease in avoided costs between FY 2011 and FY 2012 caused the passthroughs to exceed 100 percent. In Docket No. R2013-1, the discount was again set at its estimated FY 2011 avoided costs. However, the cost avoidance in FY 2012 decreased by two cents from its FY 2011 estimate. The Postal Service justifies the excessive discount under section 3622(e)(2)(B), i.e., rate shock. It contends that moving the discount in line with the cost avoidance immediately could lead to rate shock. Additionally, the Postal Service alleges that a further reduction in the discount is inadvisable given that the significant one-year reduction in the cost avoidance could be temporary.

Section 3622(e) requires that workshare discounts not exceed avoided costs, unless they qualify for at least one of the exceptions in that section. The Postal Service does not quantify the impact of any rate shock. By not quantifying the impact of any rate shock, the Postal Service is not adequately supporting the exception. *The Commission finds that the Postal Service has not demonstrated that this presort discount for 5-Digit non automation flats qualifies for any of the exceptions authorized by section 3622(e)(2). Therefore, the appropriate action is for the Postal Service to either align the discount with avoided costs when it files its next general market dominant price adjustment, or adequately support an applicable exception.*

Parcels

Six worksharing discounts for Standard Mail Parcels exceeded their avoided costs in FY 2012. The following three presort discounts exceeded avoided costs: (1) NDC Irregular Parcels[25] , 36.9 cents; (2) NDC Marketing Parcels, 41.5 cents; and (3) SCF Marketing Parcels, 37.2 cents. In addition, the following three pre-barcoding discounts exceeded their avoided costs: (1) Mixed NDC Machinable Barcoded Parcels, 6.4 cents; (2) Mixed NDC Irregular Barcoded Parcels, 6.4 cents; and (3) Mixed NDC Barcoded Marketing Parcels, 6.4 cents.

The Postal Service justifies the passthrough of the three presort discounts by citing the exception granted in 39 U.S.C. 3622(e)(2)(B). However, it has not described the nature or extent of the rate shock that would occur if rates were to be adjusted to equal avoided costs. *The Commission finds that the Postal Service has not demonstrated that the excessive discounts for NDC Irregular Parcels, NDC Marketing Parcels and SCF Marketing Parcels qualified for the exception cited. The appropriate action is for the Postal Service to either align these discounts with avoided costs when it files its next general market dominant price adjustment, or adequately support an applicable statutory exception.*

The Postal Service justifies the barcoding discounts in excess of estimated avoided cost on the basis of efficient operations, citing section 3622(e)(2)(D). Specifically, the Postal Service wants to promote a fully pre-barcoded incoming parcel mailstream which would allow the elimination of keying stations on parcel sorters, thereby increasing the efficiency of postal operations. 2012 ACR at 24. The Postal Service applies a surcharge to all Standard Mail Parcels that do not bear a correct barcode. The Postal Service notes it has plans to soon require barcodes on all ground parcels. *The Commission finds that for FY 2012, the pricing of the pre-barcoding discounts for Standard Mail Parcels is justified.*

Standard Nonprofit Mail

39 U.S.C. 3626(a)(6) requires nonprofit prices to be set in relation to their commercial counterparts regardless of nonprofits' independent costs. In Docket No. R2012-3, nonprofit prices were set to yield per-piece average revenues that were 60 percent of commercial per piece average revenues at the class level. The Commission calculates that in FY 2012, the actual per piece revenue from Standard Mail nonprofit pieces was 58.97 percent of Standard Mail commercial per piece revenue.

[25] For this category, the discount applies only to nonprofit. Its commercial counterpart was moved to the Competitive Product List. *See* Docket No. MC2010-36.

The prices approved in Docket No. R2013-1 are expected to produce average per piece revenue for nonprofit mail equal to 60 percent of the average per-piece revenue for commercial mail. *No action, therefore, is warranted.*

Commercial and Nonprofit Workshare Discounts

The Commission's review of the Postal Service's annual rate adjustment filed as Docket No. R2013-1 noted that some proposed worksharing discounts for nonprofit Standard Mail differed from their Commercial Standard Mail counterparts. In Order No. 1541, the Commission directed the Postal Service either to provide justification as to why it views the different discount levels of Standard Mail consistent with 39 U.S.C. 403(c) and not contrary to the decision in *National Easter Seal Society*[26] or to revise the discounts to make them consistent.

The Postal Service responded by proposing new discounts that narrowed the gap between the two discounts slightly. It justified the remaining discrepancy by explaining that the varying presort discounts arose from the complex task of designing rates that comply with the 60 percent commercial revenue per piece benchmark set forth in 39 U.S.C. 3626(a)(6). It stated that occasionally, compliance with the 60 percent benchmark precluded it from making nonprofit presort discounts identical to commercial presort discounts without setting the nonprofit base rate higher than would be most efficient or otherwise preferable from a policy perspective.[27] The Commission accepted the Postal Service's rationale in Order No. 1573, determining that in the circumstances of that proceeding, the justification provided was reasonable. It also directed the Postal Service to identify when nonprofit discounts differ from commercial discounts in the future and justify those differences accordingly. Order No. 1573 at 8.

The Association of Nonprofit Mailers (ANM) submitted comments in this docket regarding the legal sufficiency of the Postal Service's justification and the Commission's acceptance of that justification in Order No. 1573. The Commission's analysis of ANM's comments are discussed in detail in Chapter III of this report. *With respect to compliance with 39 U.S.C. 3622(e), the Commission determines that the finding for these nonprofit discounts is identical to its finding for commercial discounts.* Where nonprofit discounts differ from commercial discounts the passthroughs are reflected in Table VII-23.

[26] *National Easter Seal Society v. USPS*, 656 F. 2d 754 (D.C. Cir. 1981).

[27] Docket No. R2013-1, United States Postal Service Response to Order No. 1541, November 26, 2012 (Response) at 7.

Table VII—23—Standard Mail Nonprofit Workshare Discounts and Benchmarks

Type of Worksharing (Benchmark)	Year-End Commercial Discount (cents)	Year-End Nonprofit Discount (cents)	Unit Cost Avoidance (cents)	Nonprofit Passthrough
Standard Mail Letters				
Barcoding (cents/piece)				
Automation Mixed AADC Letters (Non-automation Machinable Mixed ADC Letters)	0.3	0.6	(0.3)	-200.0%
Standard Mail Flats				
Presorting (cents/piece)				
Automation 5-Digit Flats (Automation 3-Digit Flats)	8.5	7.6	8.7	87.4%
Non-automation 3-Digit Flats (Non-automation ADC Flats)	5.8	4.8	6.1	78.7%
Non-automation 5-Digit Flats (Non-automation 3-Digit Flats)	8.2	8.1	5.8	139.7%
Standard Mail Marketing Parcels				
Presorting (cents/piece)				
NDC Marketing Parcels (Mixed NDC Marketing Parcels)	41.5	37.6	30.8	122.1%
SCF Marketing Parcels (NDC Marketing Parcels)	37.2	34.4	27.5	125.1%
5-Digit Marketing Parcels (SCF Marketing Parcels)	2.4	2.2	45.4	4.8%
Standard Mail High Density and Saturation Letters				
Barcoding (cents/piece)				
High Density Letters (Carrier Route Letters)	7.2	6.9	27.4	25.2%
Standard Mail High Density and Saturation Flats/Parcels				
Presorting (cents/piece)				
High Density Flats (Carrier Route Flats)	4.7	4.5	5.4	83.3%
High Density Parcels (Carrier Route Parcels)	13.9	17.4	141.0	12.3%

Source: PRC-ACR2012-LR3.

Standard Mail Incentive Programs

There were two Standard Mail Incentive programs in effect during FY 2012: (1) the Saturation and High Density Mail Incentive Program; and (2) the 2012 Mobile Commerce and Personalization Promotion Program.

The Saturation and High Density Mail Incentive Program began on January 1, 2011, and ended on December 31, 2012. The program was designed to encourage increased mail usage from existing direct mail customers by providing a discount on incremental volume. The Postal Service gave $7.2 million in rebates to 336 customers. Rebate earners mailed 1.5 billion pieces of Saturation and High Density letter and flat mail pieces during the program period, which represented approximately 9 percent of total Saturation and High Density letter and flat volume over the same time period.

The 2012 Mobile Commerce and Personalization Program was in effect from July 1, 2012, to August 31, 2012. The primary goal of the promotion was to generate awareness of ways in which mobile technology can be integrated into mail campaigns. The program provided a discount on the eligible postage for commercial First-Class Mail and Standard Mail letters, postcards and flats that included a two-dimensional mobile barcode inside or on the mailpiece. The mobile barcode was required to point to a mobile-optimized website that either facilitated mobile commerce or was personalized to the recipient. The Postal Service paid out $13.2 million in rebates for 3.17 billion Standard Mail pieces.

Package Services

Intoduction

The Package Services class consists of five products: (1) Single-Piece Parcel Post; (2) Bound Printed Matter (BPM) Flats; (3) Bound Printed Matter (BPM) Parcels; (4) Media Mail/Library Mail; and (5) Inbound Surface Parcel Post (at UPU rates).[28] These products have common characteristics, including that they are not sealed against inspection and do not receive preferential handling or transportation. Generally, this class consists of parcels containing merchandise, although heavier catalogs and directories may also be mailed within the Package Services class. In FY 2012, 645.2 million pieces were mailed as Package Services. This accounts for less than one-half of one percent of total domestic market dominant mail volume.[29]

The principal FY 2012 findings for Package Services are:

- The attributable costs for the Package Services class, as a whole, exceeded revenues by $38.0 million, resulting in a cost coverage of 97.7 percent.
- Single-Piece Parcel Post revenues did not cover attributable costs by $65.9 million, resulting in a cost coverage of 92.2 percent.
- Media Mail/Library Mail revenues did not cover attributable costs by $55.5 million, resulting in a cost coverage of 85.3 percent.
- Four worksharing discounts exceeded avoided costs.
- Two of these discounts were properly justified under section 3622(e).
- Two of these discounts were not properly justified under section 3622(e).

Financial Analysis

Table VII-24 displays the FY 2012 financial performance for the Package Services class. Table VII-24 shows that the Package Services class had a cost coverage of 97.7 percent. Although the revenues for Package Services failed to cover attributable costs for the fourth consecutive year, the cost coverage for Package Services improved 3.4 percentage points over FY 2011. Figure VII-5 shows that the unit loss for Package Services is shrinking.

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[28] The Inbound Surface Parcel Post (at UPU rates) product is discussed in the Market Dominant International Mail Section.

[29] *See* Library Reference PRC-ACR2012-NP-LR1.

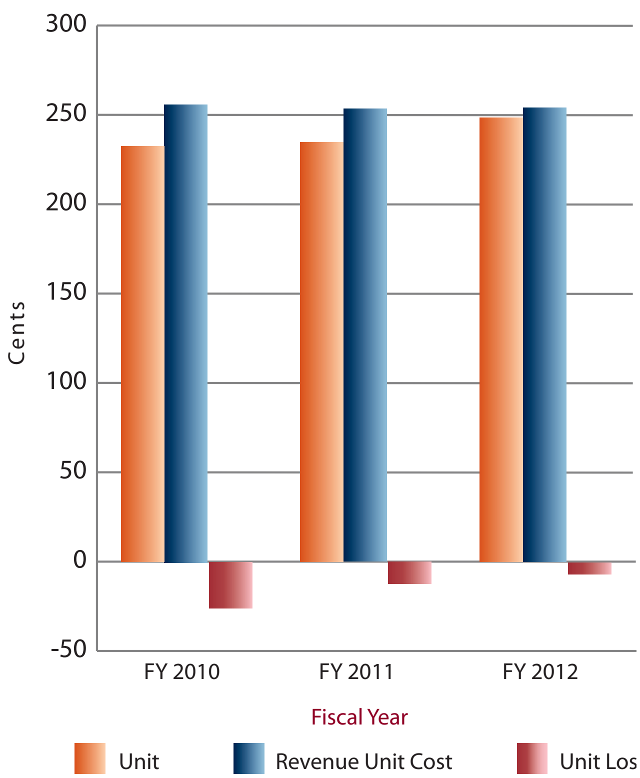
Table VII–24—Fiscal Year 2012 Volume, Revenue, Cost and Cost Coverage for Package Services

	Volume (000)	Revenue ($ 000)	Attributable Cost ($ 000)	Contribution to Institutional Cost ($ 000)	Revenue per Piece (Cents)	Cost per Piece (Cents)	Unit Contribution (Cents)	Cost Coverage
Single-Piece Parcel Post	70,970.777	774,437.727	840,358.984	(65,921.257)	1,091.206	1,184.092	(92.885)	92.2%
Inbound Surface Parcel Post (at UPU Rates) [1]	1,114.928	20,908.212	11,593.897	9,314.315	1,875.297	1,039.879	835.419	180.3%
Bound Printed Matter Flats	230,521.640	186,886.940	138,301.818	48,585.122	81.071	59.995	21.076	135.1%
Bound Printed Matter Parcels	243,307.816	306,650.521	281,152.111	25,498.410	126.034	115.554	10.480	109.1%
Media and Library Mail	100,421.982	321,245.741	376,769.966	(55,524.225)	319.896	375.187	(55.291)	85.3%
Inbound International NSA Mail Intl[1]	8.024	17.890	3.267	14.623				
Total	**645,230.239**	**1,610,147.031**	**1,648,180.043**	**(38,033.012)**	**249.546**	**254.441**	**(5.894)**	**97.7%**

Source: PRC-ACR2012–LR1.

[1] Inbound Surface Parcel Post (at UPU rates) and Inbound International NSA Mail are discussed in the Market Dominant International Mail Section.

Figure VII–5—Package Services Financial Performance



Source: PRC-ACR2012-LR5

BPM Flats, BPM Parcels, and Inbound Surface Parcel Post (at UPU rates) were the only Package Services products with revenues exceeding attributable costs in FY 2012. The remaining two products, Single Piece Parcel Post and Media Mail/Library Mail, had an overall negative contribution of $121.4 million.

Single-Piece Parcel Post

The FY 2012 cost coverage for Single-Piece Parcel Post was 92.2 percent, a 2.9 percentage point increase from FY 2011. This is the sixth consecutive year that Single-Piece Parcel Post did not generate sufficient revenues to cover attributable costs. Unit attributable costs increased by 14.7 cents and unit revenues increased by 47.5 cents, which led to an increase in contribution of 32.7 cents per piece from FY 2011 to FY 2012. Despite this improvement, Single-Piece Parcel Post's contribution remained negative. In FY 2012, Single-Piece Parcel Post's contribution was negative $65.9 million.

During FY 2012, the Commission conditionally approved the Postal Service's request to: (1) remove Single-Piece Parcel Post from the market dominant product list; (2) add a similar product, Parcel Post, to the competitive product list; and (3) leave the Alaska Bypass Service[30] subcategory of Single-Piece Parcel Post on the market dominant product list as a Package Services product offering.[31] On January 27, 2013, Single-Piece Parcel Post was removed from the market dominant product list.[32] Contemporaneously, Alaska Bypass Service was added to the market dominant product list as a Package Services product offering.[33]

BPM Flats

In FY 2012, BPM Flats had a cost coverage of 135.1 percent and contributed $48.6 million toward the Postal Service's institutional costs. Compared to FY 2011, unit revenues decreased by 0.4 cents, while unit attributable costs increased by 10.2 cents, which led to a decline in contribution of 10.6 cents per piece. Nevertheless, the revenues for BPM Flats continue to cover attributable costs each year.

BPM Parcels

In FY 2012, BPM Parcels had a cost coverage of 109.1 percent and contributed $25.5 million toward the Postal Service's institutional costs. Cost coverage for BPM Parcels improved 10.3 percentage points from FY 2011. This is the first year since FY 2009 that the revenues for BPM Parcels covered attributable costs.

Media Mail/Library Mail

In FY 2012, Media Mail/Library Mail had a cost coverage of 85.3 percent, an 8.1 percentage point increase from FY 2011. This is the sixth consecutive year that Media Mail/Library Mail did not generate sufficient revenues to cover attributable costs.

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30 Alaska Bypass Service allows shippers to send shrink-wrapped pallets of goods within Alaska from designated "hub points" to designated "bush points."

31 Docket No. MC2012-13, Order No. 1411, Order Conditionally Granting Request to Transfer Parcel Post to the Competitive Product List, July 20, 2012. The approval was conditioned on the Postal Service filing a competitive rate adjustment demonstrating that Parcel Post rates satisfied section 3633(a)(2). *Id*. at 13.

32 *See* Docket No. CP2013-3, Order No. 1536, Order Approving Changes in Rates of General Applicability for Competitive Products, November 8, 2012 at 16.

33 Docket No. R2013-1, Order on Price Adjustments for Market Dominant Products and Related Mail Classification Changes, November 16, 2012 at 69 (Order No. 1541).

In Response to CHIR No. 5, question 26, the Postal Service explains that revenues for Media Mail/Library Mail continue to fail to cover attributable costs primarily due to price cap constraints.[34] In addition, the Postal Service asserts that changes to the mail mix over the last five years may have contributed to unit costs increases that outpace inflation. Response to CHIR No. 5, question 26. The Postal Service states that the mail mix changes may indicate a decline in the percentage of Media Mail/Library Mail volume derived from large-volume shippers and an increase in the percentage derived from small-volume shippers, including internet sellers. *Id.* The Postal Service also suggests that the Media Mail/Library Mail pricing structure does not allow for corresponding increases in unit revenues to counter these mail mix changes.[35] *Id*.

Commission Analysis.

The Package Services class as a whole, as well as Single-Piece Parcel Post and Media Mail/Library Mail individually, did not cover attributable costs or make a contribution to institutional costs. Although the attributable costs for Package Services continue to exceed revenues, the Commission observes that the cost coverages for the two products that failed to cover attributable costs in FY 2012, improved over FY 2011. In addition, the changes made to the Single-Piece Parcel Post product should allow the Package Services class as a whole to improve cost coverage in upcoming fiscal years and make a contribution to institutional costs.

The Single-Piece Parcel Post product was eliminated from this class effective January 27, 2013. *As a result of the recent transfer, the Commission directs the Postal Service to report FY 2013 revenue, volume, and attributable costs data for Single-Piece Parcel Post for the period of October 1, 2012 to January 26, 2013 in its FY 2012 ACR. Similarly, the Commission directs the Postal Service to report revenue, volume, and attributable cost data for the Alaska Bypass Service product for the period of January 27, 2013 to September 30, 2013 in its FY 2013 ACR.*

With respect to Media Mail/Library Mail, the Postal Service's most recent price adjustments indicate that the Postal Service is attempting to increase the cost coverage of Media Mail/Library Mail by proposing above average price increases subject to the constraints of the annual price cap.[36] In addition, the Postal Service states that its cost saving initiatives, like Network Rationalization,[37] will help to reduce the product's unit costs, leading to improved cost coverage. *See* Response to CHIR No. 5, question 26.

The Postal Service should continue pricing Media Mail/Library Mail in a way that improves cost coverage. In addition, the Commission directs the Postal Service to discuss the effects of its Network Rationalization on Media Mail/Library Mail's unit costs in its FY 2013 ACR.

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34 Responses of the United States Postal Service to Questions 1-5, 17, 19-21, 23-26, 28-30, and 32-36 of Chairman's Information Request No. 5, February 6, 2013 (Response to CHIR No. 5).

35 Media Mail/Library Mail has a statutory restriction that requires its rates to not vary with distance. *See* 39 U.S.C. 3683. Generally, parcel products have prices that are based on zone (distance transported) and weight.

36 *See* Docket No. R2011-2, Order No. 675, Order Revising Postal Service Market Dominant Price Adjustments, February 16, 2011; Docket No. R2012-3, Order No. 987, Order on Price Adjustments for Market Dominant Products and Related Mail Classification Changes, November 22, 2011; Order No. 1541. The approved rate increases went into effect on April 17, 2011, January 22, 2012, and January 27, 2013, respectively.

37 *See* Docket No. N2012-1, Advisory Opinion on Mail Processing Network Rationalization Service Changes, September 28, 2012 (Network Rationalization).

Worksharing

Three Package Services products offered workshare discounts in FY 2012: Media Mail/Library Mail, BPM Flats, and BPM Parcels.

Media Mail/Library Mail

There were six discounts offered for Media Mail/Library Mail in FY 2012. Table VII-25 shows the FY 2012 discounts, avoided costs, and passthroughs for Media Mail/Library Mail.

Table VII–25—Media/Library Mail
Workshare Discounts and Benchmarks

	FY 2012		
Type of Worksharing (Benchmark)	Year-End Discount (cents)	Unit Cost Avoidance (cents)	Passthrough[1]
Media Mail			
Presorting (cents/piece)			
Basic (Single-Piece)	40.00	30.00	133.3%
5-Digit (Basic)	34.00	67.00	50.7%
Barcoding (cents/piece)			
Single-Piece Barcoded	3.00	3.90	76.9%
Library Mail			
Presorting (cents/piece)			
Basic (Single-Piece)	38.00	30.00	126.7%
5-Digit (Basic)	33.00	67.00	49.3%
Barcoding (cents/piece)			
Single-Piece Barcoded (Single-Piece Non-barcoded)	3.00	3.90	76.9%

Source: PRC-ACR2012-LR5.

[1] The calculated passthroughs are based on rounded unit avoided costs.

The Basic presort discount for both Media Mail and Library Mail exceeded avoided costs in FY 2012. In FY 2011, these discounts were 83.0 percent and 78.7 percent, respectively. The Postal Service notes that the significant passthrough increase is a result of the new cost avoidance calculation methodology approved in Order No. 1153.[38] Nonetheless, the Postal Service justifies these passthroughs under section 3622(e)(2)(C) since Media Mail and Library Mail are products consisting exclusively of mail matter of educational, cultural, scientific, or informational value (ECSI). The Postal Service explains that it plans to move the discounts toward their new unit cost avoidances over time.

[38] *See* Docket No. RM2012-1, Order No. 1153, Order Concerning Analytical Principles for Periodic Reporting (Proposals Nine Through Fifteen), January 20, 2012, at 14-15 .

BPM Flats and BPM Parcels

In FY 2012, there were 15 discounts offered for BPM Flats and 15 discounts for BPM Parcels. Table VII-26 and Table VII-27 show the FY 2012 discounts, avoided costs, and passthroughs for BPM Flats and BPM Parcels, respectively.

Table VII–26—Bound Printed Matter Flats Workshare Discounts and Benchmarks

Type of Worksharing (Benchmark)	FY 2012 Year-End Discount (cents)	FY 2012 Unit Cost Avoidance (cents)	FY 2012 Passthrough[3]
Presorting (cents/piece)[1]			
Basic Flats (Single-Piece Flats)	34.4	See Note [1]	N/A
Carrier Route Flats (Basic Flats)	9.8	15.1	64.9%
Presorting (cents/pound)[1]			
Basic, Carrier Route Flats (Single-Piece Flats)			
Zones 1 & 2	4.1	See Note[1]	N/A
Zone 3	5.5	See Note[1]	N/A
Zone4	5.3	See Note[1]	N/A
Zone 5	6.0	See Note[1]	N/A
Zone 6	6.2	See Note[1]	N/A
Zone 7	6.2	See Note[1]	N/A
Zone 8	7.0	See Note[1]	N/A
Barcoding (cents/piece)[2]			
Single-Piece Automation Flats (Single-Piece Non-automaion Flats)	3.0	See Note[2]	N/A
Basic, Automation Flats Basic, Non-automation Flats	3.0	See Note[2]	N/A
Carrier Route Automation Flats (Carrier Route Non-automation Flats)	3.0	See Note[2]	N/A
Drop Ship (cents/piece)			
Basic, Carrier Route DNDC Flats Basic, Origin Flats)	17.4	14.1	123.4%
Basic, Carrier Route DNDC Flats (Basic, Origin Flats)	61.5	64.8	94.9%
Basic, Carrier Route DDU Flats (Basic, Origin Flats)	76.2	79.1	96.3%

Source: PRC-ACR2012-LR5.

[1] The BPM cost model does not estimate cost differences between single piece and presorted BPM. Single-piece BPM is a residual category with low volume and adequate data are not available. Previously, rate differences between single-piece and presorted BPM were based on an assumption that unit mail processing costs for single piece BPM were twice that of presorted BPM. *See* Docket No. R2006-1, USPS-T-38, p. 8.
[2] Separate estimates of barcoding cost savings are not available for BPM Flats. Based on the cost savings for BPM Parcels, the barcoding discount for BPM Flats implies a passthrough of 76.9%.
[3] The calculated passthroughs are based on rounded unit avoided costs.

Table VII–27—Bound Printed Matter Parcels Workshare Discounts and Benchmarks

Type of Worksharing (Benchmark)	FY 2012 Year-End Discount (cents)	FY 2012 Unit Cost Avoidance (cents)	FY 2012 Passthrough[2]
Presorting (cents/piece)[1]			
Basic Parcels (Single-Piece Parcels)	60.0	See Note[1]	N/A
Carrier Route Parcels (Single-Piece Parcels)	9.8	15.1	64.9%
Presorting (cents/pound)[1]			
Basic, Carrier Route Parcels (Single-Piece Parcels)			
Zones 1 & 2	4.4	See Note[1]	N/A
Zone 3	5.0	See Note[1]	N/A
Zone 4	4.9	See Note[1]	N/A
Zone 5	4.4	See Note[1]	N/A
Zone 6	4.3	See Note[1]	N/A
Zone 7	2.7	See Note[1]	N/A
Zone 8	2.0	See Note[1]	N/A
Barcoding (cents/piece)			
Single-Piece Barcoded Parcels (Single-Piece Non-barcoded Parcels)	3.0	3.9	76.9%
Basic Barcoded Parcels (Single-Piece Non-barcoded Parcels)	3.0	3.9	76.9%
Carrier Route Barcoded Parcels (Single-Piece Non-barcoded Parcels)	3.0	3.9	76.9%
Drop Ship (cents/piece)			
Basic, Carrier Route DNDC Parcels (Basic, Origin Parcels)	17.4	14.1	123.4%
Basic, Carrier Route DSCF Parcels (Basic, Origin Parcels)	61.6	64.8	95.1%
Basic, Carrier Route DDU Parcels (Basic, Origin Parcels)	76.2	79.1	96.3%

Source: PRC-ACR2012-LR5.

[1] The BPM cost model does not estimate cost differences between single-piece and presorted BPM. Single-piece BPM is a residual category with low volume and adequate data are not available. Previously, rate differences between single-piece and presorted BPM were based on an assumption that unit mail processing costs for single piece BPM were twice that of presorted BPM. *See* Docket No. R2006-1, USPS-T-38, p. 8.
[2] The calculated passthroughs are based on rounded unit avoided costs.

The Destination Network Distribution Center (DNDC) dropship discount for both BPM Flats and Parcels exceeds unit avoided costs. In Docket No. R2012-3, the DNDC dropship discounts for both BPM Flats and BPM Parcels reflected a 100 percent passthrough of unit avoided costs.[39] Since then, the unit avoided costs for the DNDC dropship discount for BPM Flats and BPM Parcels decreased, resulting in a 123.4 percent passthrough. *See* Tables VII-26 and VII-27. The Postal Service plans to reduce the discounts in its next price adjustment and over time to return the passthroughs to 100 percent. FY 2012 ACR at 30.

[39] *See* Docket No. R2012-3, Library Reference PRC-R2012-3-LR-4, Compliance Calculations for Package Services, Excel file "R2013-4 Package Services Worksharing.xlsx," which shows that the DNDC dropship discount and unit avoided costs were 17.4 cents for both BPM Flats and BPM Parcels.

The Postal Service recognizes that its most recent price adjustment, approved by the Commission on November 16, 2012, reduced the discounts from 17.4 cents to 17.0 cents, consistent with the FY 2011 avoided costs.[40] However, the Postal Service explains that the reduced discount is still greater than the newly calculated FY 2012 avoided cost of 14.1 cents. The Postal Service asserts that, as a general matter, it should not be expected to match discounts to cost avoidances that are not available at the time that the discounts are set.[41] *Id*., question 4.

The Postal Service claims the statutory exception in section 3622(e)(2)(B) applies to the FY 2012 DNDC dropship discounts for both BPM Flats and BPM Parcels. The Postal Service asserts that in its most recent price adjustment, if it had known that the cost avoidance was 14.1 cents in FY 2012, it still would not have immediately reduced the discounts from 17.4 cents to 14.1 cents because that would have resulted in rate shock. The Postal Service notes that reducing the discounts to 14.1 cents would have resulted in over 35 percent in reductions in discounts in a two-year span (FY 2012 compared to FY 2010).

The Postal Service states that it will reduce the FY 2012 discounts in its next price adjustment, and over time, return these passthroughs to 100 percent or below, while avoiding any drastic changes that could cause rate shock.

Comments

Comments were filed by the Public Representative.[42] No other party filed comments concerning Package Services workshare discounts. The Public Representative addresses the Postal Service's argument that it should not be expected to match discounts to cost avoidances that are not available at the time that the discounts are set. He asserts that the Commission should not accept the Postal Service's argument as a rationale for avoided costs being greater than workshare discounts. PR Comments at 40-48. The Public Representative recommends that the Commission request that the Postal Service forecast avoided costs for BPM dropship rate categories in the next price adjustment to ensure that the passthroughs for these categories move closer to 100 percent. *Id*. at 49.

Commission analysis

Section 3622(e)(2) requires the Commission to ensure workshare discounts do not exceed estimated avoided costs unless justified by a statutory exception. For FY 2012, the Commission concludes that, with the exception of the Basic presort discounts for Media Mail and Library Mail, as well as the DNDC dropship discounts for BPM Flats and BPM Parcels, Package Services workshare discounts did not exceed estimated avoided costs.

With respect to the Basic presort discounts for Media Mail and Library Mail, the Commission concludes that these discounts are justified pursuant to section 3622(e)(2)(C) since the Media Mail/Library Mail product qualifies for ECSI exemption. *To the extent practicable, the Postal Service should align these discounts with their avoided costs in its next price adjustment filing.*

With respect to the DNDC dropship discounts for BPM Flats and BPM Parcels, the Commission does not accept

40 Docket No. R2013-1, United States Postal Service Notice of Market-Dominant Price Adjustment, October 11, 2012 at 53; Order No. 1541 at 70.
41 Responses of the United States Postal Service to Questions 1-13 of Chairman's Information Request No. 3, January 22, 2013 (Response to CHIR No. 3).
42 Public Representative Comments, February 1, 2013 (PR Comments)

the Postal Service's justification pursuant to section 3622(e)(2)(B) for the discounts' excessive passthroughs. The Postal Service contends that lowering the discounts to equal avoided costs and thereby increasing the rates for dropshipping would result in a 35 percent increase in these rates over a two-year period. However, the Postal Service provides no support for how the rate increase would adversely affect mailers. For this reason, the Commission concludes that the Postal Service has not adequately supported the statutory exception it claims. *The Postal Service should either align the discounts with avoided cost in the next price adjustment or adequately support an applicable statutory exception.*

Special Services

Introduction

The Special Services class consists of twelve products, including Ancillary Services, eight domestic "stand-alone" products, and three international products. Although it is comprised of several services, Ancillary Services is classified as a single product. The three international Special Services products are discussed in the Market Dominant International Products section of the ACD. The nine domestic Special Services products are discussed herein.

The principal FY 2012 findings for Special Services are:

- Special Services contributed $494.5 million toward institutional costs, the third highest contribution among all market dominant mail classes; and
- The attributable costs for Stamp Fulfillment Services continue to exceed revenues.

Financial Analysis

In FY 2012, the Special Services class, including international products, generated $2.3 billion in revenue and incurred $1.8 billion in attributable costs.[43] The Special Services class had an aggregate cost coverage of 126.9 percent. Table VII-28 provides financial information for each of the individual Special Services products.

[43] For a discussion of international Special Services, *see* 2012 ACD at 67.

Table VII–28 — Market Dominant Special Services
Fiscal Year 2012 Volume, Cost, Revenue, and Cost Coverage by Product

Market Dominant Special Services	Units (000)	Total Revenue ($000)	Attributable Cost ($000)	Contribution to Institutional Cost ($000)	Unit Revenue (Cents)	Unit Cost (Cents)	Unit Contribution (Cents)	Cost Coverage
Domestic Special Services								
Ancillary Services Product								
Certified Mail	227,054.884	662,806.445	601,868.964	60,937.481	291.915	265.076	26.838	110.1%
Collect-on-Delivery	702.552	5,926.666	3,603.916	2,322.750	843.591	512.975	330.616	164.5%
Insurance	30,115.142	108,509.675	96,968.545	11,541.130	360.316	321.993	38.323	111.9%
Registered Mail	2,415.040	39,477.066	30,226.123	9,250.943	1,634.634	1,251.579	383.055	130.6%
Stamped Envelopes		16,584.487	6,388.716	10,195.771	—	—	—	259.6%
Stamped Cards[1]	—	2,117.462	731.090	1,386.372	—	—	—	289.6%
Other Ancillary Services[2]	2,017,035.241	696,600.567	547,851.664	148,748.903	34.536	27.161	7.375	127.2%
Total Ancillary Services	—	**1,532,022.368**	**1,287,639.019**	**244,383.349**	—	—	—	**119.0%**
Stand-Alone Products								
Address Management Services	2,404.299	15,863.591	7,715.973	8,147.618	659.801	320.924	338.877	205.6%
Caller Service[1]		92,490.305	27,045.440	65,444.865	—	—	—	342.0%
Change of Address Credit Card Auth.[1]	—	13,082.453	1,386.993	11,695.460	—	—	—	943.2%
Confirm Service	—	843.100	337.143	505.957	—	—	—	250.1%
Customized Postage	—	900.000	77.252	822.748	—	—	—	1165.0%
Money Orders[3]	108,841.460	165,092.887	110,473.570	54,619.317	151.682	101.500	50.182	149.4%
Post Office Box Service[1]		481,566.624	377,073.383	104,493.241	—	—	—	127.7%
Stamp Fulfillment Services[4]		3,298.493	5,566.808	(2,268.315)	—	—	—	59.3%
Total Stand-Alone Services	—	**773,137.453**	**529,676.562**	**243,460.891**	—	—	—	**146.1%**
Total Domestic Special Services	—	**2,305,159.821**	**1,817,315.581**	**487,444.240**	—	—	—	**126.9%**
International Special Services[5]	—	29,435.201	22,644.479	6,790.722	—	—	—	129.3%
Total Special Services	—	**2,334,595.022**	**1,839,960.059**	**494,634.963**	—	—	—	**126.9%**

Source: PRC-ACR2012-LR1.

[1] Library Reference USPS-FY12-1 dated January 10, 2013. *See also* Response to CHIR No. 10, question 3.
[2] The FY 2012 ACR did not isolate costs for Other Ancillary Services. However, the Postal Service erroneously included Package Intercept revenue of $102,086. This table does not include Package Intercept revenues.
[3] Money Order float of $1.2 million is not included in the revenue. Response to CHIR No. 1, question 9.
[4] Response to CHIR No. 1, question 12. *See also* Library Reference USPS-FY12-1.
[5] International Special Services are discussed in the International Mail section.

Cost Model Changes

In Order No. 1153, the Commission approved incorporating retail window-related costs and mail processing costs into several Special Services cost models.[44] These updates allow disaggregation of attributable costs where volumes are too small to accurately calculate CRA costs. *Id.* at 16. The updated cost models affect: Caller Service; Certificate of Mailing; Correction of Mailing List; Periodical Application; Post Office Box Key and Lock; Restricted Delivery; Signature Confirmation; and Zip Coding of Mailing List.[45]

In Docket No. RM2012-5, the Postal Service proposed updates to how costs are allocated in the In Office Cost System (IOCS) for the following Special Services: (1) Inbound Registered Mail, (2) Collect on Delivery (COD), (3) Certified Mail, (4) Insurance, and (5) Signature Confirmation.[46] The Commission approved the proposed update, finding that it more accurately reflected the processing of International Inbound Registered Mail and corrected inconsistencies for the COD, Certified Mail, Insurance, and Confirm Services.[47]

Ancillary Services

The Ancillary Services product is comprised of 22 services, many of which may be used only in conjunction with other mail services.[48] As shown in Table VII-28 above, in FY 2012 the Ancillary Services product earned $1.5 billion in revenue and incurred $1.3 billion in attributable costs. Ancillary Services contributed $244.4 million toward the institutional costs of the Postal Service and had a cost coverage of 119.0 percent. 2012 ACR at 31. Revenue for some Ancillary Services is allocated back to the underlying mail class. For those Ancillary Services, revenue is not included in the Ancillary Services product calculation of cost coverage.[49]

As shown in Table VII-28 above, the Postal Service reports revenue and attributable costs for six Ancillary Services: Certified Mail, Collect-on-Delivery, Insurance, Registered Mail, Stamped Cards, and Stamped Envelopes. The Postal Service reports aggregated revenue and attributable costs for five Ancillary Services—Delivery Confirmation, Restricted Delivery, Return Receipt for Merchandise, and Signature Confirmation—as "Other Ancillary Services." In FY 2012, the aggregated category and each of the six individually-reported Ancillary Services had a positive cost coverage and thus contributed toward institutional costs.

44 Docket No. RM2012-1, Order Concerning Analytical Principles for Periodic Reporting (Proposals Nine through Fifteen), January 20, 2012 (Order No. 1153).

45 Docket No. RM2012-1, USPS-LR-RM2012-1/NP1

46 Docket No. RM2012-5, Petition of the United States Postal Service for the Initiation of a Proceeding to Consider Proposed Changes in Analytical Principles (Proposals One through Five), June 26, 2012.

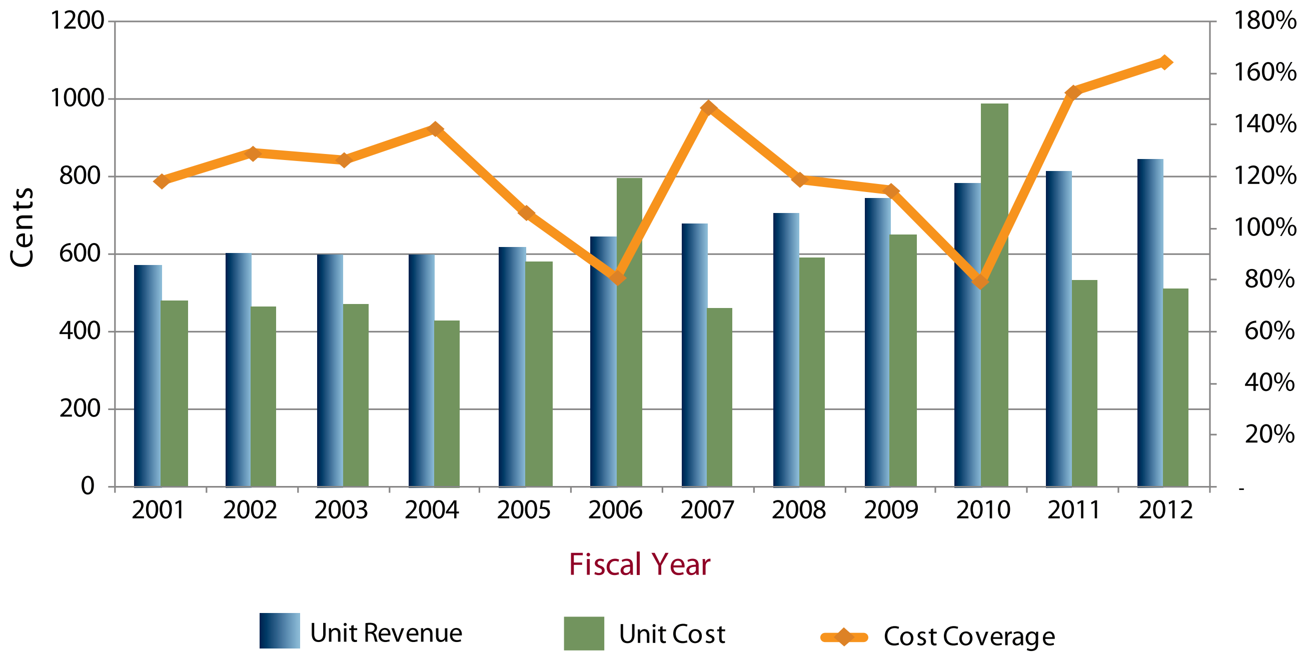
47 Docket No. RM2012-5, Order On Analytical Principles Used in Periodic Reporting, September 10, 2012, at 9-10 (Order No. 1462).

48 The domestic Ancillary Services product includes the following services: (1) Address Correction Service; (2) Applications and Mailing Permits; (3) Business Reply Mail; (4) Bulk Parcel Return Service; (5) Certified Mail; (6) Certificate of Mailing; (7) Collect on Delivery; (8) Delivery Confirmation; (9) Insurance; (10) Merchandise Return Service; (11) Parcel Airlift; (12) Registered Mail; (13) Return Receipt; (14) Return Receipt for Merchandise; (15) Restricted Delivery; (16) Shipper-Paid Forwarding; (17) Signature Confirmation; (18) Special Handling; (19) Stamped Envelopes; (20) Stamped Cards; (21) Premium Stamped Stationery; and (22) Premium Stamped Cards. In Docket No. MC2013-28, the Commission approved the Postal Service's request to change "Delivery Confirmation" service to "USPS Tracking" service. See Docket No. MC2013-28, Order Approving Minor Classification Changes Related to Certain Ancillary Services, January 24, 2013 (Order No. 1631).

49 The services for which the Postal Service reports revenue for the underlying mail product are: (1) Address Correction Services; (2) Applications and Mailing Permits; (3) Business Reply Mail; (4) Bulk Parcel Return Service; (5) Certificate of Mailing; (6) Merchandise Return Service; (7) Parcel Airlift; (8) Return Receipt for Merchandise; (9) Shipper-Paid Forwarding; and (10) Special Handling.

While most of the ancillary services have a recent history of continuous positive contributions, COD has been problematic. The Postal Service has previously explained that due to relatively low volume, COD has few tallies reported in the IOCS, resulting in year-to-year variability.[50] In FY 2010, COD had a cost coverage of 79.1 percent. In the FY 2010 ACD, the Commission proposed that the Postal Service consider using a moving average to calculate COD attributable costs or investigate an alternative sampling methodology. 2010 ACD at 125. In FY 2011, COD had a cost coverage of 152.7 percent. *Id.* at 137. The Postal Service indicated that it was continuing to use its same costing methodology as it had previously.[51] As Table VII-26 shows, COD cost coverage has varied substantially over time.

Figure VII–6—Collect on Delivery, Unit Revenue, Unit Cost, and Cost Coverage Comparison FY 2001—2012



Source: 2001—2006 CRA reports, 2007—2011 ACD reports, and Table VII-28.

In Docket No. R2012-3, the Postal Service increased COD prices by 2.8 percent. In FY 2012, the unit cost for COD declined 3.9 percent from the unit cost reported in FY 2011. Although COD volumes continued to decline in FY 2012, the rate increase and the decline in unit cost resulted in an increase in unit contribution. In FY 2012, COD revenues were $5.9 million and attributable costs were $3.6 million, resulting in COD contributing $2.3 million toward institutional costs. The FY 2012 cost coverage of 164.5 percent marks an increase of 11.8 percentage points over the FY 2011 cost coverage. Although the Postal Service continues to use its existing methodology for determining the attributable costs for COD, for two consecutive years, COD has had a positive cost coverage. Therefore, the Commission does not recommend changing the COD cost attribution methodology at this time.

[50] Docket No. ACR2010, Response of the United States Postal Service to Questions 1-31 of Chairman's Information Request No. 1, question 10, January 24, 2011.

[51] Docket No. ACR2011, Responses of the United States Postal Service to Questions 1, 3-6, 8-27, and 39-42 of Chairman's Information Request No. 1, question 19, January 27, 2012.

Stand-Alone Special Services

The eight products that comprise the stand-alone Special Services are: Address Management Services, Caller Service and Reserve Number, Change-of-Address Credit Card Authentication, Confirm Service, Customized Postage, Money Orders, Post Office Box Service, and Stamp Fulfillment Services. Only one product, Stamp Fulfillment Services, did not generate enough revenue to cover its attributable costs. Each of the other stand-alone Special Services made positive contributions to institutional costs.

Address Management Services

Address Management Services (AMS) consists of 35 services that enable bulk business mailers to better manage the quality of their mailing lists.[52] In FY 2012, AMS generated $15.9 million in revenue and had attributable costs of $7.7 million. 2012 ACR at 31. This represents a revenue and cost decline of 3.5 percent and 23.8 percent, respectively, from FY 2011.[53] As a result, the FY 2012 cost coverage for the AMS product was 205.6 percent, which is 43.2 percentage points higher than the FY 2011 cost coverage.

Caller Service

The Caller Service product is a premium service that allows eligible customers to have properly addressed mail delivered through a post office call window or loading dock.

In Docket No. RM2012-1, the Postal Service updated several cost models to incorporate a Waiting Time Adjustment Factor and a Miscellaneous Factor to Caller Service. The Postal Service indicated that the two factors were not available when the models were first developed. The Commission approved the Postal Service's proposed changes to the caller service cost model. Order No. 1153 at 18.

In FY 2012, Caller Service earned $92.5 million in revenue and incurred $27.0 million in attributable costs. The product contributed $65.4 million toward institutional costs and had a cost coverage of 342.0 percent, which was 10.3 percentage points higher than the FY 2011 cost coverage of 331.7 percent.

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52 The following is a list of the AMS services: (1) Advance Notification & Tracking System; (2) Address Sequencing; (3) Address Element Correction II Service; (4) Address Information System Viewer; (5) Carrier Route Information System (CRIS); (6) Coding Accuracy Support System Certification (CASS); (7) Change-of-Address Customer Confirmation Letter Reprint; (8) Change-of-Address Information for Election Boards & Registration Commissions; (9) City State; (10) Computerized Delivery Sequence (CDS); (11) Correction of Address Lists; (12) Delivery Statistics; (13) Domestic Mail Manual (DMM) Labeling List; (14) Delivery Point Validation (DPV) System; (15) Delivery Sequence File – 2nd Generation Service; (16) enhanced Line of Travel (eLOT) Service; (17) Five-Digit Zip; (18) Locatable Address Conversion Service (LACS Link); (19) Manifest Analysis and Certification (MAC) Batch System Certification; (20) MAC Gold System Certification; (21) MAC System Certification; (22) Multiline Accuracy Support System (MASS) Certification; (23) National Change of Address (NCOA) Service; (24) NCOA Link Service – Address Not Known Service Option; (25) Official National Zone Charts; (26) Periodicals Accuracy, Grading and Evaluation (PAGE) System Certification; (27) Presort Accuracy, Validation, and Evaluation (PAVE) System Certification; (28) Postal Explorer CD-ROM; (29) Residential Delivery Indicator (RDI) Service; (30) Z4Change; (31) Z4INFO; (32) ZIP + 4 Service; (33) ZIPMove; (34) ZIP Code Sortation of Address Lists; and (35) 99 Percent Accurate Method. In addition, the Postal Service offers three no fee services: (1) Zone Analysis Program (ZAP); (2) Barcode Certification; and (3) ZIPSPLIT. *See* Response to CHIR No. 4, question 8.

53 Compare 2012 ACR at 31 with 2011 ACD at 137.

Change-of-Address Credit Card Authentication

The Change-of-Address Credit Card Authentication product allows customers to file change-of-address requests online and over the telephone.[54] The Postal Service charges a $1 fee to verify the customer's identity. An outside vendor manages the change-of-address program.

In FY 2012, the Postal Service processed 13.1 million online and telephone Change-of-Address Authentication applications, generating $13.1 million in revenue while incurring $1.4 million in attributable costs.[55] However, the Postal Service retained only a portion of the revenue, the remainder of which was paid to the outside vendor who manages the program. *Id*. The Postal Service provided a non-public library reference that shows the contractor related attributable costs that the Postal Service incurred for this product in FY 2012.[56] Based on a review of the non-public library reference, the Commission finds that the Postal Service's revenue for the Change-of-Address Credit Card Authentication product exceeded its attributable costs in FY 2012.

The Postal Service characterizes the payments to the vendor as profit sharing. The Commission believes that the payment is more appropriately treated as an attributable cost. In the FY 2013 ACR, the Postal Service should record the payments to the vendor as part of the attributable costs.

Confirm Service

Confirm Service permits subscribing customers to obtain electronic information regarding when and where mail pieces undergo barcode scans in mail processing operations. In FY 2012, Confirm Service generated revenues of $0.8 million and incurred attributable costs of $0.3 million. 2012 ACR at 31. The contribution to institutional costs was $0.5 million and the cost coverage was 250.1 percent. *Id*.

Confirm Service will end when existing customers' subscriptions expire.[57] The Postal Service expects that other tracking services, such as the Intelligent Mail barcode (IMb) will replace Confirm Service.[58] A similar service will become a feature of mail classes that use an IMb barcode containing a registered Mailer Identification (MID) code.[59]

Customized Postage

The Customized Postage product authorizes vendors to produce stamps bearing customer-selected images. In FY 2012, Customized Postage generated $900,000 in revenue and incurred costs of $77,252. Compared with FY 2011, revenues have remained constant while costs increased 54.5 percent from the $50,000 reported in

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54 In Docket No. R2013-1, the Postal Service proposed to change the name of Change-of-Address Credit Card Authentication to Credit Card Authentication. Docket No. R2013-1, United States Postal Service Notice of Market-Dominant Price Adjustment, October 11, 2012, Attachment A at 119 (Notice). The Postal Service indicated that the change would expand the credit card authentication fee so that it applies to all credit card authentications, rather than just change-of-address applications. Notice at 55. The Commission approved this classification change. Docket No. R2013-1, Order on Price Adjustments for Market Dominant Products and Related Mail Classification Changes, November 16, 2012, (Order No. 1541) at 79.

55 2012 ACR at 31; *See also* Response to CHIR No. 10, question 3.

56 Library Reference USPS-FY11-NP26, filename "COACredit Card 2012.xls."

57 Docket No. MC2013-38, Order Approving Request to Remove Confirm Service from the Market Dominant Product List, February 19, 2013 (Order No. 1664).

58 *See* https://ribbs.usps.gov/confirm/documents/tech_guides/IMb_Tracing_User_Guide.pdf.

59 "The Mailer Identifier (MID) is a field within the Intelligent Mail barcode that is used to identify mailers. The Postal Service assigns MIDs to mail owners, mailing agents, or other service providers that request them." *See* https://ribbs.usps.gov/index.cfm?page=intellmailmailidapp.

FY 2011.[60] The Postal Service explains that the cost increase is due to an additional employee working on the product.[61] The Customized Postage product contributed $822,748 toward institutional costs and had a cost coverage of 1,165 percent.[62]

Money Orders

Money Orders enable customers to purchase an instrument for the payment of a specified sum of money. A customer may purchase a money order up to a maximum value of $1,000.

In FY 2012, Money Orders generated $165.1 million in revenue, had attributable costs of $110.5 million, and contributed $54.6 million toward institutional costs.[63] In FY 2012, Money Orders had a cost coverage of 149.4 percent, an increase of 9.5 percentage points from FY 2011. Comparing FY 2011 with FY 2012, Money Orders revenue increased by 1.5 percent while attributable costs decreased 5.0 percent.

Post Office Box Service

Post Office Box Service provides customers with a locked receptacle for the receipt of mail during specified hours of access. Market dominant Post Office Boxes are available in five different sizes and are assigned to one of eight fee groups (1-7 and E), seven of which are priced according to the market value of the postal facility.[64] The fee group and box size determine the price that a customer must pay to rent a post office box on a 3-month or semi-annual basis.

In January 2012, Post Office Box Service at approximately 6,800 service locations was transferred from the market dominant product list to the competitive product list.[65] As a result, revenue and costs for market dominant Post Office Box Service decreased substantially. For FY 2012, revenues for the market dominant Post Office Box Service were $481.6 million while attributable costs were $377.1 million. In FY 2012, Post Office Box Service contributed $104.5 million toward institutional costs and had a cost coverage of 127.7 percent. FY 2012 ACR at 31.

Stamp Fullfillment Services

The Stamp Fulfillment Services (SFS) product provides for the fulfillment of stamp orders placed by mail, phone, fax, or online to the Stamp Fulfillment Services Center (Services Center) in Kansas City, Missouri.[66] Among other tasks, the Services Center handles orders for stamps and Philatelic Sales.

Because SFS had a cost coverage of 53.1 percent in the FY 2010 ACD, the Commission recommended that the Postal Service develop a plan to improve the cost coverage. FY 2010 ACD at 129. In FY 2011, the cost coverage improved

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60 *See* 2010 ACD at 124; 2011 ACD at 140

61 Response to CHIR No. 7, question 7.

62 Library Reference USPS-FY12-1, filename "Rev_USPS-FY12-1.zip."

63 2012 ACR at 31. This revenue figure includes $1.2 million in money order float. Response to CHIR No. 1, question 9.

64 Fee group E is offered free-of-charge to customers in areas where the Postal Service does not provide carrier delivery.

65 *See* Docket No. MC2011-25, Order Approving Request to Transfer Additional Post Office Box Service Locations to the Competitive Product List, July 29, 2011 (Order No. 780) (approving transfer); Docket No. CP2012-2, Order Approving Changes in Rates of General Applicability for Competitive Products, December 21, 2011 (Order No. 1062) (approving rate changes effective January 22, 2012)

66 SFS was added to the Mail Classification Schedule Product List in 2010. See Docket No. MC2009-19, Order Accepting Product Descriptions and Approving Addition of Stamp Fulfillment Services to the Mail Classification Schedule Product Lists, July 13, 2010 (Order No. 487).

to 59.7 percent. In the FY 2011 ACR, the Postal Service reported that due to a particularly large price increase that it implemented in January 2012, it expected the cost coverage of the SFS product to improve significantly. 2011 ACR at 47.

On January 22, 2012, SFS rates increased. For orders mailed to domestic destinations, the handling fee increased to $1.25 for orders up to $50.00 and to $1.75 for orders greater than $50.00. For orders mailed to non-domestic destinations, the handling fee increased to $6.25 for orders up to $50.00 and to $6.75 for orders greater than $50.00.[67]

In FY 2012, SFS generated $3.3 million in revenue and incurred $5.6 million in attributable costs. By comparison, in FY 2011, SFS generated $3.1 million in revenue and incurred $5.2 million in attributable costs. 2011 ACD at 142. For FY 2012, SFS had a negative contribution of $2.3 million to the Postal Service's institutional costs and a cost coverage of 59.3 percent, which is 0.4 percentage points lower than the FY 2011 cost coverage.

The Postal Service asserts that had the price increase been in effect for the full year, the cost coverage would have improved relative to FY 2011. 2012 ACR at 32. The Postal Service indicates that it will "continue to attempt to move the cost coverage toward 100 percent through price adjustments as appropriate based on future circumstances."[68] On the other hand, the Postal Service "questions the value of fully covering costs" for this product when keeping its fees low "encourages centralized ordering of stamps (including many that are used for philatelic purposes rather than to purchase postal services), thereby reducing retail purchases of stamps." *Id*.

The SFS product provides shipping and handling services to fulfill customers' orders for products such as stamps and philatelic items. The revenues attributable to the SFS product are the fees that the Postal Service collects for fulfilling customer orders. The attributable costs are the costs associated with performing the shipping and handling work that goes into completing those orders. The costs associated with the sale of stamps at other venues, such as post office windows, are viewed as part of the costs of the products on which the postage is used.

The costs and revenues associated with the SFS product do not entirely capture the value that the Services Center adds to the Postal Service, and to other Postal Service products. Although SFS does not cover its attributable costs, by providing a mechanism for the centralized ordering of stamps, it reduces the costs associated with the retail purchases of stamps. Thus, it promotes the objectives of reducing costs and increasing efficiency. *See* 39 U.S.C. 3622(b)(1) and (c)(12).

The Commission has concerns with the methodology the Postal Service proposes to use to calculate the attributable costs for products whose orders are fulfilled at the Services Center. To calculate the attributable costs for the Philatelic Sales product, the work papers use total employee hours at the Services Center and attribute a fraction of those hours to Philatelic Sales.[69] To calculate attributable costs for the SFS product, the work papers appear to

67 Docket No. R2012-3, Library Reference PRC-R2012-3-LR-5, filename "PRC-R2012-3-LR5.xls."
68 Response to CHIR No. 3, question 11.
69 Library Reference USPS-FY12-28, filename "StFS Philatelic2012.xlsx," tab "Philatelic Handling," columns D through F.

use total employee work hours at the Service Center.[70] Thus, the calculation of attributable costs for SFS appears to double count employee work hours that have already been attributed to Philatelic Sales.[71] The Postal Service's attributable cost methodology for the SFS product should only reflect SFS-related work hours. *The Postal Service should provide an updated methodology for calculating the attributable costs of products handled by the Services Center in a rulemaking proceeding to change analytical principles prior to incorporating it into the FY 2013 ACR. The updated methodology should describe how the costs, revenues, and volumes are attributed to Stamp Fulfillment Services, Philatelic Services, and any other products handled at the Services Center.*

Market Dominant International Products

Introduction

Market dominant international mail consists of eight products: Outbound Single-Piece First-Class Mail International, Inbound Single-Piece First-Class Mail International (at UPU rates), Inbound Surface Parcel Post (at UPU rates), International Ancillary Services, International Reply Coupon Service, International Business Reply Mail Service and two products consisting of Negotiated Service Agreements, the Canada Post United States Postal Service Contractual Bilateral Agreement for Inbound Market Dominant Services and Inbound Market Dominant Multi-Service Agreements with Foreign Postal Operators 1.

The Postal Service establishes rates and fees of general applicability for Outbound Single-Piece First Class Mail International, outbound services within the International Ancillary Services product, International Reply Coupon Service, and International Business Reply Mail Service pursuant to the provisions of 39 U.S.C. § 3622.[72] For Inbound Single-Piece First-Class Mail International (at UPU rates), Inbound Surface Parcel Post (at UPU rates), inbound services within the International Ancillary Services product, and Inbound Reply Coupon Service, rates are determined by international agreement through the Universal Postal Union (UPU).[73] The Postal Service also establishes rates and fees for inbound international mail through Negotiated Service Agreements (NSAs) with foreign postal operators.

The principal findings for FY 2012 for market dominant international mail are:[74]

- Revenues exceeded attributable costs for all market dominant international products, including negotiated service agreements, by $152.0 million;
- Revenues for Inbound Single-Piece First-Class Mail (at UPU rates) did not cover attributable costs by $65.3 million, but the Postal Service should continue to negotiate additional compensatory bilateral or multilateral agreements;

70 Library Reference USPS-FY12-28, filename "StFS2012.xlsx," tab"Handling_LR," column D.

71 Response to CHIR No. 10, question 2.

72 Rates and fees of general applicability in effect during FY 2012 for market dominant international mail products were announced in two separate Postal Service Notices. See Docket No. R2011-2, United States Postal Service Notice of Market-Dominant Price Adjustment, January 13, 2011 (implemented April 17, 2011); Docket No. R2012-3, United States Postal Service Notice of Market Dominant Price Adjustment, October 18, 2011 (implemented January 22, 2012)

73 The Universal Postal Union is a United Nations technical agency through which international treaties governing the exchange of international mail, including the rates, are negotiated among its 192 members. The United States is a member of the UPU.

74 Unless stated otherwise, the Commission analyzes revenues and expenses for international mail products developed according to the "booked" accounting method. The use of booked revenues and expenses ensures that the Commission's financial analyses are consistent with the Postal Service's audited financial statements.

- Revenues for two inbound international products consisting of negotiated service agreements did not cover attributable costs. However, no action is recommended by the Commission given that negotiated rates for each NSA within each product improved the net financial position of the Postal Service compared to the UPU rates and therefore comply with 39 U.S.C. § 3622(c)(10).

The section below presents a financial analysis of market dominant international mail products featuring rates and fees of general applicability. This section is followed by a discussion of the quality of service link to terminal dues and market dominant international products consisting of NSAs.

Market Dominant International Products With Rates of General Applicability

Outbound Single-Piece First-Class Mail International (FCMI), Inbound Surface Parcel Post (at UPU rates) and International Ancillary Services all had an increase in contribution over FY 2011. For Inbound Single Piece First-Class Mail (at UPU rates), revenues remained below attributable costs, and the loss increased in FY 2012 compared to FY 2011. Each of these products is discussed below.

Outbound Single-Piece First-Class Mail International

Outbound Single-Piece First-Class Mail International generated $227.0 million in contribution, the largest amount of all market dominant international products. This represents an 8.3 percent increase over FY 2011. The cost coverage also increased by 4.0 percentage points, from 147.8 percent to 151.8 percent.

The improved FY 2012 financial results for Outbound Single-Piece First-Class Mail International as a whole reflect an increase in revenue that resulted from both higher rates and increased volume, and a decrease in attributable costs for Outbound FCMI to Canada. This improvement stands in marked contrast to FY 2011, when outbound FCMI to Canada reported a loss. 2011 ACR at 144. The resulting increase in contribution from Outbound FCMI to Canada offset the decrease in contribution from Outbound FCMI to all other countries in FY 2012.

Inbound Single-Piece First-Class Mail International (at UPU Rates)

Inbound Single-Piece First-Class Mail International consists of inbound letterpost sent from foreign postal operators for delivery in the United States.[75] Foreign postal operators remunerate the Postal Service for the delivery of inbound letterpost at UPU terminal dues rates or negotiated rates established in bilateral or multilateral agreements. For FY 2012, the reported loss for Inbound Single-Piece First-Class Mail (at UPU rates) was $65.3 million, almost double the loss of $33.0 million in FY 2011. The cost coverage also decreased to 67.3 percent in FY 2012 from 79.0 percent in FY 2011.

75 The term "letterpost" refers to international mail that is not classified as Parcel Post or Express Mail (EMS). Also known as LC/AO mail (*i.e.*, letters and cards, and all other, including flats and small packets), letterpost consists of mail similar to domestic First-Class Mail, Periodicals, Standard Mail, Bound Printed Matter, and Media/Library Mail, weighing up to 4.4 pounds (2.0 kilograms).

The Postal Service states that the decrease in contribution and cost coverage between FY 2012 and FY 2011 resulted from cost increases.[76] The Postal Service also notes that the slower pace of revenue growth compared to cost increases occurred in both Target and Transition system countries, although the "shortfall for the much larger Target Country category was responsible for most of the impact."[77] Increases in international mail processing costs and weight per piece were important contributing factors, as well as a change in the accepted methodology of calculating mail processing costs.[78]

More generally, the Postal Service observes that the failure of Inbound Single-Piece First-Class Mail International revenue to cover attributable costs "stems from the product's unique pricing regime." 2012 ACR at 9. Prices are set "according to a [UPU] terminal dues formula [that] is based upon a percentage of the one-ounce retail Single-Piece First-Class Mail price," instead of actual Postal Service costs. *Id.* That formula is renegotiated in the UPU once every four years. Thus, the Postal Service "does not independently determine the prices [paid by foreign postal operators] for delivering foreign origin mail" in the United States. *Id.*

The Commission recognizes that the current UPU formula used to derive terminal dues rates is not compensatory for inbound letterpost entering the United States. Moreover, UPU terminal dues rates set according to the current formula will remain in effect through 2013. As a result, the current terminal dues formula will continue to adversely affect the financial performance of Inbound Single-Piece First Class Mail International (at non-UPU rates) in the immediate future.

During the past several years the United States has played an active role in the UPU seeking ways to develop a more compensatory terminal dues formula for inbound letterpost. In this regard, negotiations to revise the formula were concluded in 2012, resulting in the adoption of a new formula to calculate terminal dues that will improve the cost coverage for inbound letterpost starting in Calendar Year (CY) 2014.

Pursuant to the UPU Convention, the Postal Service (or any postal operator) may negotiate bilateral (or multilateral) rate agreements with other postal operators as an alternative to the UPU terminal dues rates for some or all of its inbound letterpost. In recent years, the Postal Service has pursued this option to negotiate bilateral agreements with Canada Post, Post NL (Netherlands), the China Post Group, Hongkong Post, Singapore Post and Australia Post. These agreements were effective in FY 2012.

The Commission commends the Postal Service for its "strategy of negotiating bilateral agreements with some of its larger exchange partners to improve total inbound cost coverage." 2012 ACR at 9. A small number of exchange

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[76] Responses of the United States Postal Service to Questions 1-2 and 4-24 of Chairman's Information Request No. 4, January 25, 2013, question 9 (Response to CHIR No. 4).

[77] The target system refers to the UPU terminal dues system in which rates paid for the delivery of letterpost are generally based on 70% of the delivering postal operator's domestic rate for a 20 gram (or 1 oz.) letter. The per item/per kilogram rates are bound by minimum and maximum rates set by the UPU. In the target system, terminal dues payments are linked to quality of service provided in the country of destination. Primarily industrialized countries are part of the UPU target system. The transition system refers to the UPU terminal dues system in which terminal dues rates are set on a per kilogram basis using the global worldwide average weight of a letterpost item, as established by the UPU. Terminal dues in the transition system are not linked to quality of service. Primarily developing countries are part of the UPU transition system.

[78] *Id.*; *see also* Docket No. RM2012-5, Petition of the United States Postal Service for the Initiation of a Proceeding to Consider Proposed Changes in Analytical Principles (Proposals One Through Five), June 26, 2012, at 9.

partners account for a large fraction of inbound international mail. *The Commission recommends that the Postal Service continue efforts to negotiate additional compensatory bilateral (or multilateral) agreements with foreign postal operators, particularly its largest exchange partners.*

Inbound Surface Parcel Post (at UPU Rates)

During FY 2012, revenues from Inbound Surface Parcel Post (at UPU rates) exceeded attributable costs by $9.3 million, resulting in a cost coverage of 180.3 percent. Although contribution for Inbound Surface Parcel Post (at UPU rates) increased compared to FY 2011, the cost coverage decreased, reflecting decreased unit revenues.

International Ancillary Services

For FY 2012, revenues from International Ancillary Services exceeded attributable costs by $6.7 million, resulting in a cost coverage of 129.5 percent.[79] By contrast, in FY 2011 International Ancillary Services reported a loss of $6.1 million, and a cost coverage of 84.3 percent. The improvement in contribution and cost coverage for the International Ancillary Services product follows from an improvement in the financial performance of Inbound International Registered Mail service. For FY 2012, Inbound Registered Mail costs exceeded revenues by $0.8 million—a significantly smaller loss than the $13.9 million loss reported in FY 2011. The improved financial performance of Inbound Registered Mail service is largely attributable to a reduction in mail processing costs associated with the implementation of a change in the accepted methodology for calculating such costs. Response to CHIR No. 4, question 10.

The Commission understands that revenues received by the Postal Service for handling Inbound Registered Mail are constrained by fixed rates of reimbursement established pursuant to the UPU Convention. These rates are renegotiated by UPU member countries once every four years. In this regard, the Commission notes that a minimal increase in the reimbursement rate for handling Inbound Registered Mail was adopted by the UPU in 2012, to become effective in CY 2014. *The Postal Service should request the Department of State to continue to work within the UPU to ensure a more compensatory increase in rates for Inbound Registered Mail.*

International Reply Coupon Service and International Business Reply Mail Service

International Reply Coupon Service permits a mailer of outbound letterpost to prepay the postage for a reply by purchasing reply coupons from the Postal Service that are exchangeable for postage stamps issued by foreign postal operators located in member countries of the UPU. International Business Reply Mail Service allows a business mailer to include envelopes or cards within its outbound mail that can be deposited with and returned by foreign postal operators through the Postal Service to the business mailer in the United States without the prepayment of postage. Instead, postage and fees for these returned inbound letterpost items are paid upon delivery by the business mailer.

For FY 2012, International Reply Coupon Service and International Business Reply Mail Service generated a small

[79] The International Ancillary Services product consists of the following special services: Certificate of Mailing, Registered Mail, Inbound Registered Mail, Return Receipt, Inbound Return Receipt, Restricted Delivery, Inbound Restricted Delivery, and Customs Clearance and Delivery Fee (Inbound).

amount of revenue for the Postal Service. As discussed in the FY 2011 ACD, the Postal Service does not separately report costs for either service. 2011 ACR at 147. Rather, such cost data are included in the costs reported for Inbound Single-Piece First-Class Mail International, *i.e.*, Inbound Air LC/AO. *Id.*

In the FY 2011 ACD, the Commission requested that the Postal Service report on the feasibility of providing separately reported costs for International Reply Coupon Service and International Business Reply Mail Service. *Id*. The Postal Service did not directly respond to the Commission's request. Nevertheless, in its most recent notice of a market dominant price adjustment, the Postal Service proposed to eliminate outbound International Reply Coupon Service, effective in FY 2013.[80] The Commission approved the Postal Service's request.[81]

Given the absence of separately reported costs for International Reply Coupon Service and International Business Reply Mail Service, the Commission is unable to evaluate the FY 2012 financial performance of these two products. *The Commission directs that, with elimination of outbound International Reply Coupon Service, the Postal Service report on the feasibility of providing separately reported costs for International Business Reply Mail Service in the FY 2013 ACR.*

Quality of Service Link to Terminal Dues

Revenues for the delivery of inbound letterpost are derived from terminal dues payments. Under the UPU's Quality Link Measurement System (QLMS), such payments are adjusted for the quality of service provided in the country of destination for inbound letterpost coming from other countries participating in the system. The Unipost External Measurement (UNEX) system, managed by the International Post Corporation, measures the service performance of letterpost delivered in some participating countries, including the Postal Service.[82] Quality of service for some postal operators is also measured by the UPU's Global Monitoring System (GMS).[83]

As an incentive for participating in the system, the Postal Service receives an automatic 2.5 percent increase in its terminal dues payments from other participating postal operators. The Postal Service is also eligible for an additional 2.5 percent bonus payment if service performance achieves the UPU established annual quality of service performance target. For the Postal Service, the FY 2012 target remained at 88 percent for inbound letterpost delivered within the domestic overnight, two-day, and three-day service standards for First-Class Mail.

As discussed above, terminal dues payments from UPU-member countries to the Postal Service for delivering inbound letterpost did not cover attributable costs during FY 2012. This reflects in part the fact that the Postal Service's on-time service performance scores did not meet the UPU quality of service target for calendar year

80 Docket No. R2013-1, United States Postal Service Notice of Market-Dominant Price Adjustment, October 11, 2012, at 55. Although eliminating outbound International Reply Coupon Service, inbound Reply Coupon Service will continue to be offered as a service obligation of member countries of the UPU.

81 *See* Docket No. R2013-1, Order No. 1541, Order on Price Adjustments for Market Dominant Products and Related Mail Classification Changes, November 16, 2012.

82 Located in Brussels, Belgium, the International Post Corporation works on behalf of numerous postal administrations, including the Postal Service, to improve service quality, promote cooperation and interoperability, and provide intelligence about postal and related markets. For more information, see www.ipc.be.

83 http://www.upu.int/en/activities/global-monitoring-system/gms-description.html

2011.[84] As a result, the Postal Service had to forego additional revenue, albeit small, as it also incurred penalties during CY 2011, which includes the first quarter of FY 2012 (October-December 2011).

The Postal Service explains that the CY 2011 results were adversely affected by large inbound volume flows from developing countries that do not link their terminal dues payments to service performance. Many of these countries do not follow the usual preparation requirements established for participants in the Quality Link Measurement System.[85] Because of these circumstances, the Postal Service presents an alternative report for CY 2011 on-time service performance scores based upon an extract from the UPU GMS. The alternative report excludes the inbound volumes primarily from developing countries that do not follow the QLMS preparation requirements. These alternative on-time service performance scores, which are relied upon by the UPU to determine quality of service link bonus payments and penalties to the Postal Service, show an improvement over the CY 2011 scores based upon UNEX and GMS results.

Preliminary service performance scores from the UNEX system for January through September 2012 generally show an overall improvement in the monthly on-time performance scores compared to the same monthly scores reported in CY 2011. Response to CHIR No. 1, question 5 (nonpublic). This improvement is also reflected in the CY 2012 year-to-date on-time performance score, which compares favorably to the CY 2011 annual score. These scores suggest that for CY 2012, service performance is improving, although not enough to meet the UPU quality of service target for calendar year 2012.

The Postal Service also states that domestic service standards changed effective July 1, 2012. Response to CHIR No. 5, question 2(b). It adds that these changes "have not yet been reflected in the UPU QLMS measurement performance metrics," which require UPU approval. *Id.* In April 2013, the UPU Postal Operations Council meets to consider whether or not to include the service standard changes in the QLMS. The Postal Service points out that because actual service is still being measured against the older, more stringent domestic service standards, measured service performance will be adversely affected. *Id.* As a result, service performance trended upward from January to June, and dropped thereafter. *Id.*

The Commission observes that if the UPU includes the new service standards in the QLMS performance measurement metrics, and measurement is based only upon inbound volumes from countries following the QLMS preparation requirements, measured service performance scores may improve in future years.

Market Dominant International Products Consisting of Negotiated Service Agreements

The Postal Service reports financial results for two inbound international products that are comprised of Negotiated Service Agreements. The Canada Post–United States Postal Service Contractual Bilateral Agreement for Inbound

84 Responses of the United States Postal Service to Questions 1-9 and 12-15 of Chairman's Information Request No. 1, January 14, 2013, question 5. The information was filed under seal in USPS-FY12-NP31.

85 Responses of the United States Postal Service to Questions 1-5, 17, 19-21, 23-26, 28-30, and 32-36 of Chairman's Information Request No. 5, February 6, 2013, question 2(a) (Response to CHIR No. 5).

Market Dominant Services and the Inbound Market Dominant Multi-Service Agreements with Foreign Postal Operators 1 products are included on the market dominant product list. In addition, the Postal Service reports financial results for inbound Global Direct Entry with Foreign Postal Administrations. Both inbound international products and Global Direct Entry with Foreign Postal Administrations contain rates for inbound letterpost that are established through negotiated agreements with foreign postal operators as an alternative to UPU terminal dues rates.

For FY 2012, the Commission concludes the inbound international negotiated service agreements that comprise the two inbound international products satisfy the requirements of section 3622(c)(10). Each product, as well as inbound Global Direct Entry with Foreign Postal Administrations, is discussed below.

Canada Post–United States Postal Service Contractual Bilateral Agreement for Inbound Market Dominant Services

Revenues from terminal dues rates negotiated pursuant to the Canada Post–United States Postal Service Contractual Bilateral Agreement did not cover attributable costs during FY 2012. These results represent a reversal of the financial performance reported for FY 2011, when inbound letterpost revenue from Canada exceeded attributable costs.

The Postal Service points out that the bilateral agreement with Canada Post was in effect for all of FY 2011, but only for Quarter 1 (October-December 2011) of FY 2012. For Quarters 2-4 (January-September 2012), inbound letterpost from Canada entered pursuant to a renegotiated bilateral agreement, and the financial results were reported as part of the Inbound Market Dominant Multi Service Agreements with Foreign Postal Operators 1 product. The Postal Service states that a consistent year-to-year comparison between FY 2011 and FY 2012 would include financial results for all four quarters of FY 2012 for inbound letterpost from Canada reported by both products.[86]

While combining the financial result of the two bilateral agreements would permit a consistent fiscal year comparison, the Commission's task is to review the performance of each NSA separately for compliance with section 3622(c)(10).[87] For the first quarter of FY 2012, revenues for the Canada Post Bilateral Agreement did not exceed attributable costs. Because the agreement expired, thereby terminating the product, there is no need for action. For FY 2012, Quarters 2—4, available data suggest that the cost coverage for the bilateral agreement with Canada Post exceeds the cost coverage that would be obtained using UPU Target System rates. *This shows that the bilateral agreement with Canada Post improves the net financial position of the Postal Service, and thereby conforms with the requirements of section 3622 (c)(10).*

Inbound Market Dominant Multi-Service Agreements with Foreign Postal Operators 1

This inbound international product is comprised of seven negotiated service agreements with six foreign postal operators: China Post Group, Canada Post Corporation, Post NL (Netherlands), Singapore Post, Australia Post

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86 Responses of the United States Postal Service to Question 1-6 and 8-13 of Chairman's Information Request No. 8, February 15, 2013, question 1 (Response to CHIR No. 8).

87 Analysis of the financial results for the renegotiated Canada Post bilateral agreement, reported as part of the Inbound Market Dominant Multi-Service Agreements product, is included in the next section.

Corporation, and Hongkong Post. For FY 2012, revenues from terminal dues rates negotiated pursuant to these bilateral agreements did not cover attributable costs for the product as a whole. Moreover, revenues for six of the seven bilateral agreements did not cover their respective attributable costs, including the Post NL and a Hongkong Post agreement.

In its request seeking Commission approval of the Post NL agreement and the Hongkong Post agreement, the Postal Service maintained that the negotiated rates established pursuant to these agreements would result in an improvement over the "default" UPU terminal dues rates that would otherwise be applicable to inbound letterpost from Post NL and Hongkong Post. For FY 2012, the Postal Service claims that the "contract-specific rate for both the NL Post and Hongkong Post bilateral agreements are providing above-UPU cost coverage for the actual volumes exchanged." Response to CHIR No. 8, question 2. In a further response to a CHIR, the Postal Service provides additional financial data to support its claim.[88] *A Commission analysis of the other bilateral agreements for which revenues did not cover their respective attributable costs shows that these agreements also improve the net financial position of the Postal Service in conformance with the requirements of section 3622 (c)(10).*

Global Direct Entry with Foreign Postal Administrations

Global Direct Entry with Foreign Postal Administrations consists of "arrangements" with eight foreign postal operators. These arrangements permit such operators to enter inbound letterpost bearing the indicia of the respective domestic mail classes directly with the Postal Service for delivery in the U.S. The inbound letterpost is entered at negotiated rates.

The Postal Service notes that these largely informal arrangements predate Commission regulation of market dominant products pursuant to the PAEA.[89] Consequently, these arrangements are not included on the market dominant product list. Nevertheless, these arrangements are treated as a product for purposes of analysis.

During FY 2012, inbound letterpost items were received from the postal operators of only five countries: Belgium, France, Germany, Singapore, and Switzerland. *Id.* Based upon the FY 2012 financial results provided for these five foreign postal operators, revenues exceeded attributable costs for Global Direct Entry Contracts with Foreign Postal Administrations as a whole, thereby making a contribution to the institutional costs of the Postal Service.

In the FY 2011 ACD, the Commission recommended that the Postal Service act promptly to add all bilateral arrangements for global direct entry of inbound letterpost to the market dominant product list as part of the Mail Classification Schedule (MCS). The Postal Service did not formally respond to the Commission's recommendation. In its most recent notice of market dominant price adjustment, the Postal Service proposed a 0.1 cent per piece handling charge applicable to foreign-origin inbound direct entry of single-piece First-Class Mail, subject to the terms of an authorization agreement. Response to CHIR No. 4, question 4. The Commission approved the Postal Service's classification change. Order No. 1541 at 13–14.

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[88] Responses of the United States Postal Service to Questions 1-3 of Chairman's Information Request No. 10, March 1, 2012, question 1.

[89] Response to CHIR No. 5, question 4. The Postal Service states that, "Except for Deutsche Post DHL and Swiss Post, these arrangements were entered into informally." *Id*.

The Commission observes that approval of this change effectively brings inbound direct entry of letterpost by foreign postal operators into the MCS. The Postal Service states that it "plans to continue its efforts to formalize these arrangements by entering into authorization arrangements with foreign postal operators." Response to CHIR No. 5, question 4.

Market Tests

Four market dominant market tests were in effect during FY 2012: Alternate Postage Payment Method for Greeting Cards, Every Door Direct Mail–Retail (EDDM-R), First-Class Tracer, and Mail Works Guarantee. Section 3641 authorizes the Postal Service to conduct market tests of experimental products. A product may not be tested, however, unless it satisfies each of the following conditions:

1. the product is significantly different from all products offered by the Postal Service within the two-year period preceding the start of the test (section 3641(b)(1));
2. the product will not result in undue market disruption, especially for small business concerns (section 3641(b)(2)); and
3. the product is correctly characterized as either market dominant or competitive (section 3641(b)(3)).

In addition, market tests of experimental products may not exceed 24 months (section 3641(d)), or annually exceed $10 million in revenue (section 3641(e)). The Commission may exempt a market test from the $10 million revenue limitation for certain market tests up to a $50 million annual revenue limit (section 3641(e)(2)).[90]

None of the market dominant market tests in effect during FY 2012 exceeded 24 months in duration. With the exception of EDDM-R, the revenues of the market dominant market tests were within the applicable statutory revenue limits.

Alternate Postage Payment Method for Greeting Cards

In Docket No. MT2011-1, the Commission authorized the Postal Service's request to conduct a 24-month market test for Alternate Postage Payment Method for Greeting Cards.[91] This product enables individuals to mail greeting cards without affixing postage. The Commission also granted the Postal Service an exemption from the $10 million revenue limitation for this experimental market test. The Alternate Postage Payment Method for Greeting Cards market test began on or about January 1, 2011. For FY 2012, the Postal Service reports a volume of 3,623,487 Greeting Cards sold using the Alternate Postage Payment Method. The total revenue for Alternate Postage Payment Method in FY 2012 was $1,739,274. For FY 2012, the Postal Service reported $215,404 in information technology costs.

[90] Section 3641(g) mandates an annual adjustment in the dollar limits based on the change in CPI. The Commission expects to issue regulations for this calculation in FY 2013.

[91] *See* Docket No. MT2011-1, Order No. 1577, Order Granting Motion Concerning Market Test, December 13, 2012.

Every Door Direct Mail-Retail (EDDM-R)

In Docket No. MT2011-3, the Commission approved the EDDM-R market test on March 1, 2011.[92] EDDM R is restricted to locally-entered and locally-paid mail and must be delivered to every household on a delivery route. Participants are limited to sending 5,000 pieces per post office, per day. In order to make mail more accessible to small and medium businesses, the market test does not require a mailer to acquire a permit or pay mailing fees. The market test also instituted simplified qualification and preparations requirements. Pieces were priced using the Standard Mail Commercial Saturation Flats pricing schedules. In Order No. 1164, the Commission granted the Postal Service an exemption from the $10 million limitation, allowing a $50 million annual limitation.[93] In Docket No. MC2012-31, the Postal Service requested to add EDDM-R to the market dominant product list.[94] On September 7, 2012 the Commission approved the Postal Service's request.[95] In FY 2012, the Postal Service reports that 450 million pieces were sent under EDDM-R. The Postal Service also reports that the revenue for EDDM-R was $65,304,052 and the attributable cost was $31,861,054, resulting in $33,442,998 in contribution to institutional costs. *The Commission finds that the revenue for EDDM-R in FY 2012 exceeds the limitation in 3641(e)(2). As the Postal Service has concluded this market test, no action is required.*

First-Class Tracer

In Docket No. MT2012-1, the Commission approved the First-Class Tracer (Tracer) market test on December 9, 2011.[96] This product provides customers with a three-step process to track the transportation and processing of single-piece First-Class Mail. First, the mailer affixes the Tracer barcode label to a single piece of First-Class Mail. Second, the mail is scanned and sorted by existing mail processing equipment. Third, the customer keeps a portion of the label that consists of a tracing number and a QR[97] code, which enables them to go to the USPS.com website and check the status of the respective piece of First-Class Mail either by entering the tracing number at the Track and Confirm section of USPS.com, or by scanning the QR code with a mobile device. For FY 2012, the Postal Service reports a volume of 1,972 pieces sold. The total revenue for First-Class Tracer in FY 2012 was $3,692. For FY 2012, the Postal Service reported $7,000 in product development costs.

Mail Works Guarantee

In Docket No. MT2011-4, the Commission authorized the Mail Works Guarantee market test on May 15, 2011. For this market test, the Postal Service and each participant jointly develop a unique set of metrics to measure the effectiveness of a particular direct mail campaign. The Postal Service plans to provide assistance to the mailer in developing its direct mail and in benchmarking and measuring the test metric. The Postal Service offers a postage

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92 *See* Docket No. MT2011-3, Order No. 687, Order Approving Market Test of Experimental Product–Marketing Mail Made Easy, March 1, 2011.
93 *See* Docket No. MT2011-3, Order No. 1164, Order Granting Request for Exemption from Annual Revenue Limitation, January 23, 2012.
94 *See* Docket No. MC2012-31, Request of the United States Postal Service to Add Every Door Direct Mail–Retail to the Mail Classification Schedule, July 10, 2012.
95 *See* Docket No. MC2012-31, Order No. 1460, Order Approving Addition of Postal Services to the Mail Classification Schedule Product Lists, September 7, 2012.
96 *See* Docket No. MT2012-1, Order No. 1035, Order Approving Market Test of First-Class Tracer, December 9, 2011.
97 QR code (abbreviated from Quick Response Code) is the trademark for a type of matrix barcode (or two-dimensional bar code). Smartphone users can install an app with a QR-code scanner that can read a displayed code and convert it to a URL directing the smartphone's browser to the website of a company, store, or product associated with that code providing specific information.

back guarantee up to $250,000 per participant if a campaign fails to achieve the pre-established metric, as verified by the Postal Service. The market test began on June 14, 2011. In FY 2012, no customers committed to using the mail in a way that would qualify for the Mail Works Guarantee market test. The Postal Service reports that it incurred some minimal costs in contacting potential customers.[98] However, it did not quantify these costs. The Postal Service contends that it was not practical to track these costs.

Commission Analysis

The Commission supports efforts by the Postal Service to develop new products. Market tests allow the Postal Service to experiment with product ideas and to gather data needed to support a permanent change in mail classification. EDDM-R is a positive example of a market test that has been successful by producing substantial new revenue and has become a new permanent offering. Based on FY 2012, the results for the Alternate Postage Payment Method for Greeting Cards suggests a similar revenue opportunity for the Postal Service.

Market Dominant Negotiated Service Agreements

Negotiated service agreements (NSAs) are contracts between a specific mailer and the Postal Service that provide the mailer with discounts (rebates) designed to encourage higher mail volumes and contribution. The Commission bases its review of market dominant NSAs on their performance during "contract years," *i.e.*, 12-month periods measured from the time that the contract was first implemented. In FY 2012, the Postal Service had one domestic market dominant NSA in effect. Contract year 1 of the NSA with Discover Financial Services (Docket Nos. R2011-3 and MC2011-19) ran from April 1, 2011 through March 31, 2012. The Postal Service was authorized to implement an agreement with Valassis (Docket Nos. R2012-8 and MC2012-14) during FY 2012. No volume was mailed pursuant to the Valassis agreement in FY 2012. 2012 ACR at 32.

When requesting approval of the Discover Financial Services (Discover) NSA, the Postal Service stated the "objective of this multi-class market dominant agreement is to maintain the total contribution the Postal Service receives from DFS First Class and Standard postage[,] and to provide an incentive for net contribution to grow beyond that."[99] Pursuant to the agreement, Discover receives rebates on "qualifying mail"[100] if its total revenue exceeds the agreed upon revenue threshold.[101] In contract year 1, the revenue threshold was $263.7 million, which Discover exceeded by $7.2 million.[102] The Discover NSA provides Discover with a rebate of a portion of the price increase during the contract year on eligible volume (75 percent of the price increase for First-Class Mail and 37.5 percent of the price increase for Standard Mail). Table VII-29 details the rebate calculation for contract year 1.

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98 *See* Response to CHIR No. 12, question 1.

99 Docket Nos. MC2011-19 and R2011-3, Notice of the United States Postal Service of Filing of Contract and Supporting Data and Request to Add Discover Financial Services Negotiated Service Agreement to the Market-Dominant Product List, January 14, 2011, at 2 (Docket Nos. MC2011-19 and R2011-3, Notice).

100 Discover earns rebates on all Intelligent Mail Barcodes (IMb) mail pursuant to the agreement. Mail that qualifies for other promotions, such as the mobile barcode promotion, or is not prebarcoded with an IMb does not qualify for rebates pursuant to the NSA.

101 The NSA has a threshold adjustment mechanism aimed at maintaining Discover's First-Class Mail revenue. In contract year 1, Discover generated over $400,000 more First-Class revenue than in the baseline period. Consequently, the threshold adjustment was not activated.

102 The rebate threshold is 110 percent of the Discover revenue for the year prior to the agreement. The baseline revenue was $248.8 million. However, revenue from the 2010 Summer Sale was not included, bringing the eligible baseline revenue to $239.7 million. $239.7 million times 1.1 is $263.7.

Table VII–29—Calculation of Contract Year 1 Rebate

	First Class	Standard	Total
Eligible Volume	200,235,004	893,490,495	1,093,725,499
Rebate Per Piece	$0.013	$0.003	
Total Rebate	$2,571,996	$3,051,958	$5,623,954

Source: PRC-ACR2012-LR6.

As detailed in the table, Discover received rebates of $5,623,954 in contract year 1 on 1.094 billion pieces qualifying for the rebate.

Because the NSA is targeted at maintaining or increasing the overall contribution from Discover's volume, it is informative to evaluate how volume, revenue, and contribution changed from the baseline period to the contract year 1 period. Table VII-30 compares the total revenue and contribution generated by Discover in the baseline and contract year 1 periods. Table VII-31 details the volume breakdown between First-Class Mail and Standard Mail during those same periods.

Table VII–30—Discover Total Revenue and Contribution

	Total Revenue	Total Contribution
FY 2010	$194,903,075	$105,945,888
Baseline	$248,765,974	$134,769,988
Contract Year 1 Before Rebate	$270,905,476	$147,855,818
Contract Year 1 After Rebate	$265,281,522	$142,231,865

Note: Baseline and Contract Year 1 Revenue and Contribution do not include Promotion and Summer Sale discounts
Source: PRC-ACR2012-LR6.

Table VII–31—Discover Total First-Class and Standard Volume and Revenue

	First Class		Standard		Total	
	Volume	Revenue	Volume	Revenue	Volume	Revenue
FY 2010	224,761,744	78,265,348	604,769,202	116,637,727	829,530,964	194,903,075
Baseline	225,319,325	$81,533,029	840,100,963	$167,277,025	1,065,420,288	$248,810,053
Contract Year 1	228,518,630	$81,961,772	920,182,042	$188,943,703	1,148,700,672	$270,905,476

Note: Baseline and Contract Year 1 Volume figures include all mail, including non-qualifying discounted volume.

Source: PRC-ACR2012-LR6.

When the Postal Service proposed the Discover NSA, it used the FY 2010 Discover volume as an estimated baseline. In FY 2010, Discover mailed 225 million pieces of First-Class Mail and 605 million pieces of Standard Mail, for a total of 830 million pieces. In the baseline period used for calculating the rebate threshold of February 1, 2010 through January 31, 2011, Discover increased its First-Class Mail volume to 225 million and Standard Mail volume to 840 million, for a total of 1.065 billion pieces. In the 4 months between the beginning of FY 2010 and the beginning of the actual baseline period (February 1, 2010), Discover increased its volume by 236 million pieces. Discover further increased its volume by 83.2 million pieces in contract year 1.

Table VII–32—Discover Estimated and Actual Volumes

	Discover FY 2010 Volume	Postal Service Projection of Contract Year 1 Volume	Discover Pre-implementation Volume—Feb. 2010 to Jan. 2011	Contract Year 1 Volume—Apr. 2011 to Mar. 2012
	[1]	[2]	[3]	[4]
First Class	224,761,744	202,285,570	225,319,325	228,518,630
Standard - Low	604,769,202	661,214,328	840,100,963	920,182,042
Standard - High	N/A	681,373,301	N/A	N/A
Total	829,530,946	863,499,897 to 883,658,871	1,065,420,288	1,148,700,672

Source: PRC-ACR2012-LR6.

Table VII–33—Postal Service Estimate of Net Contribution

	YR 1 Projected Volume	YR 1 Actual Volume							
	W/O Incentives (Before Rates)	With Incentives (After Rates)	Incremental	Unit Rev/ Pc.	Unit Cost/ Pc.	Unit Contrib.	Total Contribution	Earned Rebate	Net USPS Value
First Class	202,285,570	228,518,630	26,233,060	$0.359	$0.119	$0.240	$6,299,228	$2,571,996	$3,727,233
Standard Mail	661,214,328	920,182,042	258,967,714	$0.205	$0.104	$0.101	$26,168,197	$3,051,958	$23,116,239
(Low Volume Estimate)									
Total	863,499,898	1,148,700,672					$32,467,425	$5,623,954	$26,843,472
Standard Mail	681,373,301	920,182,042	238,808,741	$0.205	$0.104	$0.101	$24,131,171	$3,051,958	$21,079,213
(High Volume Estimate)									
Total	883,658,871	1,148,700,672					$30,430,399	$5,623,954	$24,806,446

Source: PRC-ACR2012-LR6.

Postal Service Calculation of Net Financial Benefit

In Docket No. R2011-3, the Postal Service estimated the agreement would generate an increase of $2 to $15 million in contribution over the 3-year span of the agreement using its methodology. Docket Nos. MC2011-19 and R2011-3, Notice at 5. The Postal Service provided estimates of Discover contract year 1 volumes as part of its Docket No. R2011-3 filing. Table VII-32 details the Discover FY 2010 volume, the Postal Service's estimate of Discover contract year 1 volume at the time of proposal, the actual baseline volume, and Discover's contract year 1 volume

In its 2012 ACR, the Postal Service estimates that the Discover NSA resulted in a net contribution increase of between $24.8 million and $26.8 million. It calculates net contribution by comparing contract year 1 actual results (column 4 above) with Postal Service projected year 1 volume (column 2 above). Table VII-33 details the Postal Service estimate of net contribution.

The Postal Service's net contribution method assumes that all volume greater than the projected contract year 1 volume is due to the rebate. For First-Class Mail this amounted to 26.3 million pieces. The unit contribution of Discover's First-Class letters is, on average, 24.0 cents per piece. Thus, the 26.3 million pieces had a contribution of $6.3 million. The First-Class rebate was $2.5 million. The Postal Service estimates the net value after the First-Class rebate was $3.7 million.

For Standard Mail, the Postal Service develops two alternative assumptions, Standard Mail – Low and Standard Mail – High. The Postal Service estimates that between 238 million and 258 million pieces of Standard Mail are due to the rebate. The unit contribution of Discover's Standard letters is, on average, 10.1 cents per piece. Thus, the 238 to 258 million incremental pieces had a contribution of $24.1 million to $26.1 million. The Standard Mail rebate was $3.1 million. The Postal Service estimates the net value after the Standard Mail rebate was $21.1 to $23.1 million.

The Postal Service combines its net value calculations for First-Class and Standard Mail and estimates that the Discover NSA increased net contribution by between $24.8 million and $26.8 million in contract year 1.

Commission Analysis

When proposing the NSA, the Postal Service used Discover's FY 2010 volume to develop a projection of what Discover would mail without an agreement. This projection is contained in Table VII-32, column 2. The Postal Service estimated that, without a rebate, Discover would increase its overall volume from 829 million to between 863 and 884 million pieces in contract year 1. The Postal Service uses the projected volume of between 863 and 884 million pieces as the starting point to measure the volume incentivized by the rebates. The Postal Service calculation assumes that all of the variation in volume between the projected year and contract year 1 was caused by the rebate.

As shown in Table VII-32 column 3, Discover increased its volume by 236 million pieces in the 4 months between the proposal and implementation of the NSA, to 1.065 billion pieces. Discover's pre-implementation volume was between 182 and 212 million pieces higher than the Postal Service's projection of contract year 1 volume before the rebates took effect. Discover further increased its volume over the actual baseline by 83 million pieces in contract year 1, to 1.149 billion pieces.

The Postal Service assumes that between 265 million and 285 million pieces were incentivized by the rebate. Discover's volume increased by 83.2 million in contract year 1. The majority of the volume that the Postal Service assumes was incentivized by the rebate was being mailed by Discover before the rebates were being offered. Because the Postal Service method does not use quantitative factors to estimate the response to the rebate, the Commission does not find the Postal Service method should be used to evaluate the net financial benefit of the agreement.

The Commission uses the accepted methodology to isolate the impact of the NSA rebates on Postal Service finances. The purpose of the Commission methodology is to estimate mailer response to a lower price using quantitative inputs. The accepted methodology incorporates the contract year 1 rebated volume, the marginal rebate, and the Standard Regular and First-Class own-price elasticities.[103] The Commission recognizes that the elasticity of individual mailers may differ from that of the class as a whole. The Commission methodology uses class elasticities because they are the only available elasticity estimates at this time.

In contract year 1, 200.2 million First-Class Mail pieces qualified for the marginal rebate of 1.3 cents per piece.[104] Using the 2012 First-Class elasticity of -0.392, 2.8 million pieces were incentivized by the rebate. The Postal Service gained $0.6 million in contribution from these pieces.

In contract year 1, 893 million Standard pieces qualified for a 0.3 cent rebate.[105] Using the 2012 Standard elasticity of -0.437, 6.5 million pieces were incentivized by the rebate. The Postal Service gained $0.7 million in contribution from these pieces. Under the accepted methodology, roughly 9.3 million incremental pieces can be attributed directly to the rebates. Using the Commission's accepted methodology, the estimated increase in contribution from incentivized volume in contract year 1 of the Discover NSA is about $1.3 million. However, since the Postal Service paid rebates of $2.5 million for First-Class Mail volumes and $3.1 million for Standard Mail volumes, the estimated net benefit to the Postal Service of the NSA with Discover in contract year 1 was a negative $4,337,569.[106]

The Postal Service estimates that 26.2 million First-Class pieces were incentivized by the rebate. This implies that Discover would need to have an elasticity of -3.8 to be incentivized to mail 26.2 million pieces by a marginal rebate of 1.3 cents. This is roughly 10 times the own-price elasticity of the class. The Postal Service estimates that over 238 million Standard Mail pieces were incentivized by the rebate. This implies that Discover would need an

103 The Postal Service's estimates of elasticity reflect subclasses, rather than products, that were used prior to the PAEA. Standard Regular includes the following commercial Standard Mail products: Letters, Flats, and NFMs/Parcels. ECR refers to Enhanced Carrier Route. It includes the following commercial products: Carrier Route, High Density and Saturation Letters, and High Density and Saturation Flats and Parcels. The accepted methodology was developed in Docket No. MC2004-3. The 2012 Standard Mail Regular elasticity is -0.437 and the First-Class elasticity is -0.392, as provided in the attachment to the January 20, 2013 letter from Andrew German. The Postal Service provides its estimates of price elasticity pursuant to the Commission's Periodic Data Reporting Rules.

104 *See* Table VII-29, eligible First-Class volume.

105 *See* Table VII-29, eligible Standard volume.

106 The formula for estimating the incremental volume incentivized by a rebate is (Eligible Volume x (1-Revenue Per Piece/(Revenue Per Piece-Marginal Rebate))$^{\text{Own-Price Elasticity}}$). The incentivized volume is multiplied by the contribution per piece of the incentivized volume to calculate the increase in contribution due to the incentivized volume

elasticity of -18.5 to be incentivized to mail 238 million pieces by a marginal rebate of 0.3 cents, roughly 42 times the own-price elasticity of the class.

Table VII-34 below shows the net effect on the contribution to institutional costs of the Discover NSA for contract year 1 given the actual rebates paid.

Table VII–34—Summary of NSA Net Effect on Contribution (Thousands)

	FY 2012
Discover	$(4,338)

Source: PRC-ACR2012-LR6.

Section 3622(c)(10) of title 39 requires that special classifications improve the net financial position of the Postal Service or improve operational performance, while not causing competitive harm. The Discover NSA, under the approach employed by the Commission, is estimated to have had a negative effect on the net financial position of the Postal Service in FY 2012. When approving the NSA, the Commission noted that the NSA was unlikely to improve the Postal Service's net financial position using the approved methodology. *See* Order No. 694 at 14-15. However, the Commission stated that "allowing this negotiated service agreement to proceed will allow management to enhance its knowledge of potential tools to slow the overall declining trend for First-Class Mail volume." *Id.* at 15. The Postal Service did not make any statements regarding the value of any insight it may have gained from this NSA in its ACR.

The Commission finds that, under the existing methodology, the Discover NSA would have satisfied section 3622(c)(10) if the total rebate was less than $1.3 million in contract year 1. The agreement implemented by the Postal Service was designed to pay rebates for all of Discover's qualifying volume, and in contract year 1 the rebate was greater than the contribution incentivized by the agreement. As implemented by the Postal Service, the contract year 1 results of the NSA are inconsistent with section 3622(c)(10). As noted by the Commission in Order No. 694, "the agreement may be canceled by either party should experience prove to be at odds with the parties' expectations." *Id.* at 16. The NSA is scheduled to remain in effect for 3 years, and could be profitable for the Postal Service in year 2, which concludes March 31, 2013. *If the Postal Service is not realizing a net benefit due to the agreement or the insights gained by its implementation by that time, the Commission recommends that the Postal Service re-evaluate the benefits and costs of continuing the NSA.*

Chapter VIII

Competitive Products

Introduction

In this chapter, the Commission reviews competitive products, including competitive negotiated service agreements, to determine whether any rates or fees in effect during FY 2012 were not in compliance with 39 U.S.C. 3633, which:

- Prohibits subsidization of competitive products by market dominant products – section 3633(a)(1);
- Requires that each competitive product cover its attributable costs – section 3633(a)(2); and
- Requires that, collectively, competitive products cover an appropriate share of the Postal Service's institutional costs – section 3633(a)(3).

The Commission also includes an analysis of competitive market tests and the Competitive Products Fund at the end of this chapter.

The principal FY 2012 findings for competitive products are:

- Revenues for competitive products, as a whole, exceeded the incremental costs of competitive products. Thus, market dominant products did not subsidize competitive products during FY 2012, satisfying section 3633(a)(1).
- Revenues for the following four products did not cover attributable costs and thus, did not comply with section 3633(a)(2): Global Plus 2B, Global Plus 2C, Inbound Air Parcels Post (at non-UPU rates), and Inbound International Expedited Services 3. The Commission orders the Postal Service to take corrective action.
- Competitive products, collectively, satisfied the Commission's 5.5 percent minimum contribution regulatory requirement. As a result, competitive products complied with section 3633(a)(3) during FY 2012.

The list of competitive products for FY 2012 is shown in Table VIII-1.

Table VIII–1—FY 2012 Competitive Domestic and International Products

DOMESTIC
Express Mail
Priority Mail
Parcel Select
Parcel Return Service
First-Class Package Service
Address Enhancement Service
Competitive Ancillary Services
Greeting Cards and Stationery
Premium Forwarding Service
Post Office Box Service
Shipping and Mailing Supplies
Domestic Competitive NSA Products[1]
INTERNATIONAL
Outbound International Expedited Services
Outbound Priority Mail International
Inbound Air Parcel Post (at UPU rates)
International Priority Airlift (IPA)
International Surface Airlift (ISAL)
International Direct Sacks M-Bags
International Ancillary Services
International Money Transfer Service - Inbound
International Money Transfer Service - Outbound
International Competitive NSA Products[2]

Source: 39 CFR 3020 subpart A, App. A.

[1] *See* Library Reference, USPS-FY2012-NP27 for a complete list of FY 2012 domestic competitive NSAs.
[2] *See* Library Reference, USPS-FY2012-NP2 for a complete list of FY 2012 international competitive NSAs.

Table VIII-2 contains FY 2012 revenue, cost, and volume for several groupings of competitive products.

Table VIII–2—Fiscal Year 2012 Volume, Revenue, Cost and Cost Coverage Selected Competitive Products and Competitive Product Groupings

Competitive Products	Volume (000)	Revenue ($000)	Attributable Cost ($000)	Contribution ($000)	Revenue per Piece (Cents)	Cost per Piece (Cents)	Contribution per Piece (Cents)	Cost Coverage
Express Mail	39,823.055	801,560.870	467,226.544	334,334.326	2,012.806	1,173.256	839.550	171.6%
Priority Mail	824,201.977	5,939,725.959	4,545,341.193	1,394,384.766	720.664	551.484	169.180	130.7%
Parcel Select and Parcel Return Service	984,202.117	1,456,216.417	1,105,766.568	350,449.849	147.959	112.352	35.608	131.7%
First-Class Package Service	411,423.642	875,653.893	766,718.621	108,935.272	212.835	186.357	26.478	114.2%
Competitive International Mail	273,525.370	1,837,316.673	1,216,597.730	620,718.943	671.717	444.784	226.933	151.0%
Competitive Domestic Services[1]		504,824.107	273,118.070	231,706.037				184.8%
Competitive International Services[2]		10,577.100	8,390.526	2,186.574				126.1%
Total Competitive Mail and Service	**2,533,176.161**	**11,425,875.019**	**8,383,159.253**	**3,042,715.766**	**451.049**	**330.935**	**120.115**	**136.3%**

Source: PRC-ACR2012-NP-LR1.

[1] Competitive Domestic Services include the following 6 products: Address Enhancement Service; Competitive Ancillary Services; Greeting Cards and Stationery; Post Office Box Service; Premium Forwarding Service; and Shipping and Mailing Supplies.
[2] Competitive International Services include the following 3 products: International Ancillary Services; International Money Transfer Service - Inbound; and International Money Transfer Service-Outbound.

In FY 2012, competitive products, as a whole, generated $11.4 billion in revenue and incurred $8.4 billion in attributable costs, resulting in a contribution of $3.0 billion. Competitive products' share of total contribution has grown from 6 percent in FY 2008 to 13 percent in FY 2012, demonstrating the growing importance of competitive products to the Postal Service.

Cross-Subsidy Provision: Section 3633(a)(1)

In Order No. 399, the Commission approved the Postal Service's hybrid incremental cost methodology.[1] Under this methodology, the Postal Service aggregates the following three cost categories: (1) incremental costs for domestic competitive mail; (2) attributable costs for international competitive products;[2] and (3) competitive group specific costs.[3]

For FY 2012, the hybrid incremental cost methodology produced an incremental cost for competitive products of $8.5 billion. The total revenues for competitive products in FY 2012 were $11.4 billion. *See* Table VIII-2.

1 *See* Docket No. RM2010-4, Order Accepting Analytical Principles Used in Periodic Reporting (Proposals Twenty-Two through Twenty-Five), January 27, 2010, at 2-5 (Order No. 399).
2 Order No. 399 established that in lieu of incremental costs, international competitive mail would use attributable costs because incremental costs are not available for international products. *Id.* at 5.
3 The Public Representative also concluded that competitive products revenues exceed the FY 2012 hybrid incremental costs. PR Comments at 50-51.

Accordingly, revenues from competitive products exceeded the FY 2012 hybrid incremental costs. *Consequently, the Commission finds that revenues from market dominant products did not subsidize competitive products, satisfying section 3633(a)(1).*

Product Cost Coverage Provision: Section 3633(a)(2)

Section 3633(a)(2) requires the revenues for each competitive product to cover attributable costs. Below, the Commission separately discusses the FY 2012 financial performance for the following: domestic competitive products; domestic competitive negotiated service agreements; international competitive products; and international competitive negotiated service agreements.

Domestic Competitive Products

In FY 2012, there were 11 domestic competitive products. Those products were: (1) Express Mail; (2) Priority Mail; (3) Parcel Select; (4) Parcel Return Service; (5) First-Class Package Service;[4] (6) Address Enhancement Service; (7) Competitive Ancillary Services; (8) Greeting Cards and Stationery; (9) Premium Forwarding Service; (10) Post Office Box Service; and (11) Shipping and Mailing Supplies.

Of the 11 domestic competitive products, there was one product that the Commission previously noted could potentially not comply with section 3633(a)(2) in FY 2012. On August 16, 2010, the Postal Service requested to transfer the market dominant commercial Standard Mail Parcels to the competitive product list as a "lightweight" subcategory of the Parcel Select product. *See* Docket No. MC2010-36. An important issue arose during the proceeding—rates for the Standard Mail Parcels being transferred did not cover attributable costs and would have caused the Parcel Select product to not cover its attributable costs as required by 39 U.S.C. 3633(a)(2).

In Order No. 689, the Commission conditionally granted the Postal Service's request to transfer commercial Standard Mail Parcels to the competitive product list with the stipulation that the Postal Service must file a notice of competitive price adjustment for Parcel Select rates, including Lightweight Parcel Select parcels, demonstrating that such rates satisfy 39 U.S.C. 3633(a) and 39 C.F.R. part 3015.

On November 22, 2011, the Postal Service filed a notice with the Commission concerning changes in rates of general applicability for competitive products. In Order No. 1062, the Commission determined that the Postal Service met the conditions outlined in Order No. 689 concerning the transfer of commercial Standard Mail Parcels from the market dominant product list to the competitive product list as a lightweight subcategory of the Parcel Select product. These changes became effective on January 22, 2012.

The Commission reviewed the revenue and attributable costs for Parcel Select in FY 2012. *See* PRC-ACR2012-NP-LR1. *The Commission finds that in FY 2012, the Parcel Select product generated sufficient revenue to cover attributable costs.*

[4] First-Class Package Service was the only new domestic competitive product offered in FY 2012. *See* Docket No. MC2011-22, Order Adding Lightweight Commercial Parcels to the Competitive Product List, April 6, 2011 (Order No. 710). *See also* Docket No. MC2011-29, Order Approving Proposed Classification Change, October 11, 2011 (Order No. 903) (renaming the product First-Class Package Service).

Along with the Parcel Select Product, the remaining 10 domestic competitive products generated sufficient revenue to cover attributable costs. Collectively, all domestic competitive products generated $9.6 billion in revenue, and incurred $7.2 billion in cost. Thus, domestic competitive products had a contribution of $2.4 billion. *The Commission finds that all domestic competitive products complied with section 3633(a)(2).*

While the Commission finds that each domestic competitive product complied with section 3633(a)(2), the Commission is concerned about the financial reporting of two competitive offerings: Package Intercept Service, a service offering under the Competitive Ancillary Services product; and competitive Post Office Box service. Each offering is discussed below.

The Commission has two concerns with the financial reporting for Package Intercept Service.[5] First, the Postal Service's accounting systems did not identify costs for Package Intercept Service in FY 2012. *See* Response to CHIR No. 5, question 10. Instead, the Postal Service provided an estimate of Package Intercept Service's unit attributable costs. *Id.* Second, although Package Intercept Service is a competitive service, the Postal Service reported its revenues and volumes with the market dominant Special Services class. *The Commission directs the Postal Service to ensure that its accounting systems capture costs for Package Intercept Service in FY 2013. In addition, the Commission directs the Postal Service to file a methodology for estimating the attributable costs of Package Intercept Service in a rulemaking proceeding prior to incorporating the methodology in its FY 2013 ACR. The Commission also directs the Postal Service to report revenues, volumes, and attributable cost data for Package Intercept Service with the Competitive Ancillary Services product.*

The methodology that the Postal Service used to develop attributable costs for the enhanced services for the competitive Post Office Box service also requires review. The Postal Service reports these costs in two line items: (1) handling of third-party carrier packages; and (2) information technology costs.[6] With respect to the handling costs, the Postal Service's workpapers indicate that it relied on an October 2011 operational study of 49 service locations to estimate the number of packages handled in FY 2012. *Id.* The Postal Service explains that it plans to update this estimate for FY 2013 by counting packages during a representative period at a sample of post offices that offer this service. *Id.* The Postal Service further indicates that in the future, after the Product Tracking System is upgraded, it will identify third-party carrier packages, where possible, by scanning the third-party carrier labels. *Id.*

With respect to the information technology costs, the Postal Service provides a total estimate for the information technology costs, but does not show how it was developed. An adequate explanation of how information technology costs are developed must be included in the Postal Service's costing methodology.

The Commission directs the Postal Service to develop a costing methodology that adequately measures the attributable costs of the enhanced services for the competitive Post Office Box service. The Commission also directs the Postal Service to file the proposed methodology in a rulemaking proceeding prior to including the methodology in any future competitive rate adjustment for competitive Post Office Box service or in its FY 2013 ACR.

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5 The Postal Service began offering Package Intercept Service on January 22, 2012.

6 *See* USPS-FY2012-NP26, Excel file "Competitive and Market Dominant P. O. Box Attributable Costs 2012.xlsx," tab 'Comp. & MD PO Box Costs. *See also* Response to CHIR No. 8, question 7.

Domestic Competitive Negotiated Service Agreements

In FY 2012, there were 63 domestic competitive NSAs. Commission regulations require that the Postal Service file data with the Commission allowing for the evaluation of each competitive NSA for compliance with section 3633. *See* 39 C.F.R. 3050.21(g)(2). With the exception of the First-Class Package Service NSAs, the Postal Service provided total volume, revenue, and cost data for each domestic competitive NSA that was in effect during FY 2012.

The Postal Service noted that First-Class Package Service contracts paid published, not discounted, prices, and that the sole purpose of the contracts was to allow partners to use the PC Postage payment method during a time when this payment method was not authorized for First-Class Package Service rates. Response to CHIR No. 8, question 10. The Postal Service further explained that as of January 27, 2013, PC Postage is now an authorized payment method for First-Class Package Service, and thus, contracts are no longer required. *Id.*

For those reasons, the Postal Service did not track First-Class Package Service NSAs and, instead, included the financial data for First-Class Package Service NSAs with the First-Class Package Service product. *Id.* In lieu of providing contract-specific financial data for the First-Class Package Service NSAs, the Postal Service filed a non-public library reference that developed an FY 2012 unit cost and unit revenue estimate representative of First-Class Package Service NSAs. *Id.*

The Commission recognizes the unique position of First-Class Package Service NSAs and understands the Postal Service's rationale for reporting the financial data with the First-Class Package Service product. However, the Commission must review each NSA to determine compliance with section 3633(a)(2). *Therefore, in future ACRs, the Commission directs the Postal Service to separately report the financial data for each First-Class Package Service NSA. In addition, the Commission urges the Postal Service to review each First-Class Package Service NSA and determine if the contract is no longer required. For contracts that are no longer necessary, the Commission directs the Postal Service to file a request to remove the contracts from the competitive product list.*

Pursuant to section 3633(a)(2), each domestic competitive NSA product must cover its attributable costs. *The Commission finds that each domestic competitive NSA for which the Postal Service filed contract-specific data covered its attributable costs and complied with the statutory requirements of section 3633(a)(2). Since the Postal Service did not file contract-specific data for the First-Class Package Service NSAs, the Commission cannot make a definitive finding pursuant to section 3633(a)(2) for these NSAs. Since each First-Class Package Service NSA paid published prices and those prices were found to satisfy section 3633(a)(2) in FY 2012, it is likely that each First-Class Package Service NSA also satisfied section 3633(a)(2) in FY 2012.*

Competitive International Products with Rates of General Applicability

Competitive international mail consists of nine products featuring rates and fees of general applicability.[7] These products are: (1) Outbound International Expedited Services, (2) Outbound Priority Mail International, (3) Inbound Air Parcel Post (at UPU rates), (4) International Priority Airmail (IPA), (5) International Surface Airlift (ISAL), (6) International Direct Sacks-M-Bags, (7) International Money Transfer Service—Outbound, (8) International Money Transfer Service—Inbound, and (9) International Ancillary Services.[8]

For FY 2012, the Commission concludes that each of the above-referenced competitive international mail products, with the exception of the International Money Transfer Service-Inbound (IMTS-Inbound) product, satisfies section 3633(a)(2).[9] Additional information is necessary to permit the Commission to determine whether the IMTS-Inbound product satisfies section 3633(a)(2).

International Money Transfer Service-Inbound

For FY 2012, the Postal Service only presents revenue for the IMTS-Inbound product in the International Cost and Revenue Analysis (ICRA) report.[10] The Postal Service states that no costs (volume variable or product specific) were reported because there were no foreign origin "tallies" in FY 2012. As a result, "all volume variable and product specific costs were attributed to IMTS-Outbound." Response to CHIR No. 4, question 11(a).

The absence of FY 2012 cost data for the IMTS-Inbound product is problematic. It precludes the Commission for the first time from evaluating the IMTS-Inbound product for consistency with section 3633(a)(2).

With respect to volumes (transactions), the Postal Service states that "volume data for the overall Inbound IMTS product is not available." Response to CHIR No. 4, question 11(b)-(c). The Postal Service adds that this condition exists because there is "no method for retrieving inbound IMTS product information from the non-POS-enabled offices."[11]

Transaction data were not provided in FY 2011 either. Such data are necessary to calculate unit revenues and costs, which permit the Commission to evaluate and compare the year-to-year financial performance of a product.

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7 Rates and fees of general applicability in effect during FY 2012 for competitive international mail products were established pursuant to Order No. 603. *See* Docket No. CP2011-26, Order No. 603, Order Approving Changes in Rates of General Applicability for Competitive Products, December 2, 2010 (implemented January 11, 2011); Docket No. CP2012-2, Order No. 1062, Order Approving Changes in Rates of General Applicability for Competitive Products, December 21, 2011 (implemented January 22, 2012).

8 The competitive International Ancillary Services product consists of the following services: Certificate of Mailing, Registered Mail, Return Receipt, Restricted Delivery, Insurance, and Customs Clearance and Delivery Fee (Inbound).

9 Unless stated otherwise, this section analyzes revenues and expenses for international mail products developed according to the "booked" accounting method. The use of booked revenues and expenses ensures that the Commission's financial analyses are consistent with the Postal Service's audited financial statements. The Postal Service also reports "imputed" revenues, presented in the FY 2012 ICRA. Imputed revenues differ from booked revenues reported in the Postal Service's financial statements and the Revenue, Pieces and Weight (RPW) report.

10 USPS-FY12-NP2 (non-public), Excel file Reports (Booked).xls, worksheet tab A Pages (c), at page A-2. The ICRA report presents revenues, costs, and volumes for each of the Postal Service's outbound and inbound international mail products.

11 *Id.* The Postal Service relies on a retail point-of-service (POS) system, consisting of terminals and associated software, at many of its larger, high-traffic post offices. Known as POS ONE, the system is designed to automate and simplify retail window service transactions, such as the weighing and rating of parcels, and record transactional data on products and services sold. However, POS ONE is not operational in numerous, generally smaller, post offices, i.e., "non-POS-enabled" offices.

In the FY 2011 ACD, the Commission directed the Postal Service "to provide IMTS-Inbound transaction volumes based upon the POS system as presented in Proposal Eleven."[12] Proposal Eleven represents the established methodology for reporting of IMTS-Outbound and IMTS-Inbound financial results, including the provision of IMTS-Inbound transactions.[13] The Commission also directed the Postal Service to estimate IMTS-Inbound transactions through other means if such volumes could not be estimated as described in Proposal Eleven. FY 2011 ACD at 158.

The Postal Service does not address this aspect of the Commission's directive. Even though non-POS-enabled offices do not report IMTS-Inbound transactions, the Postal Service is reimbursed by foreign postal administrations for the cost of paying-out and processing foreign origin money orders cashed (or electronic transfers accessed) at post offices in the United States. The Postal Service does not explain whether such revenues could be used as a basis for estimating inbound transaction volumes.

The Commission directs the Postal Service to report on the feasibility of a special study designed to estimate the transaction volume and attributable costs of the IMTS-Inbound product within 90 days. The Postal Service is to report on estimating IMTS-Inbound transaction volumes based upon the POS system as presented in Proposal Eleven. As stated in the FY 2011 ACD, if the Postal Service "no longer believes that Proposal Eleven is feasible, it should propose a modification by following accepted procedures, *i.e.*, initiating a rulemaking proceeding." *Id. The Postal Service shall also report on the feasibility of using revenues received from foreign postal operators as a basis for estimating IMTS-Inbound transaction volumes within 90 days.*

Competitive International Products Consisting of Negotiated Service Agreements

Competitive international mail also includes a number of products with rates and fees established pursuant to one or more NSAs—negotiated contracts between the Postal Service and a qualifying mailer or foreign postal operator that govern outbound or inbound international mail. Such contractual agreements often require a minimum volume and/or revenue commitment by mailers or foreign postal operators in exchange for reduced rates from the Postal Service.

In general, each international NSA is classified as a separate competitive product.[14] The Commission must evaluate each international NSA for its consistency with section 3633(a)(2), which requires that the revenues for each product cover its attributable costs.

In some cases, international NSAs that exhibit similar cost or market characteristics may be grouped together into a single product under one category. The grouping of functionally equivalent NSAs was permitted to address administrative concerns involving product reporting and classification on the competitive (and market dominant) product lists. Such functionally equivalent international NSAs are collectively evaluated as a product for

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12 FY 2011 ACD at 158. *See also* Docket No. RM2011-5, Petition of the United States Postal Service Requesting Initiation of a Proceeding to Consider Proposed Changes in Analytic Principles (Proposals Nine – Twelve), December 20, 2010, Proposal Eleven; Docket No. RM2011-5, Response of the United States Postal Service to CHIR No. 1, question 1.

13 Docket No. RM2011-5, Order No. 724, Order Concerning Analytical Principles for Periodic Reporting (Proposals Ten Through Twelve), at 6.

14 Docket No. RM2007-1, Order No. 43, Order Establishing Ratemaking Regulations for Market Dominant and Competitive Products, October 29, 2007, at 57 and 75.

consistency with section 3633(a)(2). The Commission's grouping of functionally equivalent NSAs, at the behest of the Postal Service, was done with the express understanding that each NSA within a product grouping must cover its attributable costs.[15]

To that end, the draft Mail Classification Schedule specifically requires that the revenue for each international NSA grouped under the following categories covers its attributable costs: Inbound International Expedited Services, Inbound Direct Entry Contracts with Customers, Inbound Direct Entry Contracts with Foreign Postal Administrations, and International Business Reply Service Competitive Contracts.[16] Similarly, Governors' Decisions for products established under the following categories authorize management to enter into NSAs for which the negotiated prices will generate sufficient revenues to cover attributable costs: Inbound Air Parcel Post (at non-UPU rates), Inbound Surface Parcel Post (at non-UPU rates), and Inbound Competitive Multi-Service Agreements with Foreign Postal Operators 1.[17] Thus, the Commission also separately evaluates each functionally equivalent NSA within a product for consistency with section 3633(a)(2).

The Postal Service reports volume, revenue and cost data on each international NSA. For FY 2012, the Postal Service provides such data on 383 international NSAs, of which 362 apply to outbound mail and 21 apply to inbound mail.[18] The financial results for competitive outbound international and inbound international products that consist of international contracts are discussed separately below.

Competitive Outbound International Products Consisting of Negotiated Service Agreements

Competitive outbound international products with negotiated rates are classified on the competitive product list as shown in Table VIII-3, which presents the products by category. In some cases, the category is the name of the product; in others, a different name is given to one or more products under the same heading.

For FY 2012, the Postal Service reports financial results for outbound NSAs in the following products: Global Direct Contracts, GEPS 3, GEPS—NPR 2, GEPS—NPR 3, Global Plus Contracts 1B, 1C, 2B, 2C, and GREPS 1. Based upon the data provided, 360 of the 362 outbound international contracts generated sufficient revenues to cover their attributable costs. Of the two NSAs that did not generate sufficient revenue to cover their attributable costs, one is included in the Global Plus 2B product and the other in the Global Plus 2C product. For each product, attributable costs exceed revenues. As a result of the losses incurred by these NSAs, both the Global Plus 2B and Global Plus 2C products failed to satisfy section 3633(a)(2).

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15 *See, e.g.*, Docket Nos. CP2011-34, CP2011-35, CP2011-36, CP2011-37 and CP2011-38, Order No. 601, Order Approving Five Additional Global Expedited Package Services 3 Negotiated Service Agreements, December 1, 2010, at 5. *See also* Notice of United States Postal Service of Filing Functionally Equivalent Inbound Competitive Multi-Service Agreement with a Foreign Postal Operator, November 30, 2012 at 2.

16 *See* draft Mail Classification Schedule 2515.6 (Inbound International Expedited Services), 2515.4 (Inbound Direct Entry Contracts with Customers), 2515.5 (Inbound Direct Entry Contracts with Foreign Postal Administrations) and 2515.3 (International Business Reply Service Competitive Contracts).

17 *See* Docket Nos. MC2009-24 and CP2009-28, Request of the United States Postal Service to Add Royal Mail Inbound Air Parcel Post Agreement to the Competitive Products List and Notice of Filing (Under Seal) Contract and Enabling Governors' Decision, April 21, 2009; Docket Nos. MC2009-8 and CP2009-9, Request of United States Postal Service to Add Canada Post—United States Postal Service Contractual Bilateral Agreement for Inbound Competitive Services to the Competitive Product List, and Notice of Filing (Under Seal) the Enabling Governors' Decision and Agreement, November 13, 2008; Docket Nos. MC2010-34 and CP2010-95, Request of United States Postal Service to Add Inbound Competitive Multi-Service Agreements with Foreign Postal Operators to the Competitive Product List, and Notice of Filing (Under Seal) of Enabling Governors' Decision and Negotiated Service Agreement, August 13, 2010.

18 The Postal Service also reports financial results for multiple NSAs in a single line item entry in the GEPS – NPR2 and GEPS – NPR3 products, respectively. Response to CHIR No. 5, question 5. The Commission cannot determine how many NSAs are in these two line item entries for purposes of reporting the number of NSAs in effect during FY 2012. However, the financial results of these two entries are included in the totals of their respective products.

Table VIII–3—FY 2012 Competitive Outbound International Products Grouped by Category

Category	Product
Global Bulk Economy Contracts	(Same)
Global Direct Contracts	(Same)
Global Expedited Package Services Contracts	GEPS 3 GEPS 4
Global Expedited Package Services—Non-Published Rates	GEPS—NPR 2 GEPS—NPR 3
Global Plus Contracts	Global Plus 1B Global Plus 1C Global Plus 2B Global Plus 2C
Global Reseller Expedited Package Services Contracts	GREPS 1

Source: 39 CFR 3020 subpart A, App. A.

The Commission concludes that all other competitive outbound international products consisting of NSAs provided contribution to the institutional costs of the Postal Service and therefore satisfy section 3633(a)(2).

Global Plus 2B and Global Plus 2C

NSAs within the Global Plus 2B and Global Plus 2C products provide volume-based rates to Postal Qualified Wholesalers (PQWs) and other high-volume mailers that market mailing services to their end-use customers who ship mail and articles via any combination of the following: International Priority Airmail (IPA), International Surface Air Lift (ISAL), Global Bulk Economy (GBE), Global Direct (GD), Global Express Guaranteed (GXG), Express Mail International (EMI), Priority Mail International (PMI), Commercial ePackets (CeP), and International Business Reply Service (IBRS). One service offering within Global Direct is outbound Admail™ to Canada.

The Global Plus 2B and 2C products each consist of two NSAs. One NSA in each product did not generate sufficient revenue to cover attributable costs. For the Global Plus 2B product, that NSA was the subject of Docket No.CP2011-41.[19] For the Global Plus 2C product, the NSA was the subject of Docket No. CP2012-10.[20] Each of these NSAs caused attributable costs to exceed revenues for its respective product.[21]

The FY 2012 financial results for the Global Plus 2B and 2C products continue to generate insufficient revenue to cover attributable cost. In the FY 2011 ACD, the Commission found that the Global Plus 2A product did not comply

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19 *See* Docket Nos. MC2011-8, CP2011-41 and CP2011-42, Request of the United States Postal Service to Add Global Plus 2B to the Competitive Products List and Notice of Filing Two Functionally Equivalent Global Plus 2B Contracts Negotiated Service Agreements and application for Non-Public Treatment of Materials Filed Under Seal, December 9, 2010.

20 *See* Docket Nos. MC2012-5, CP2012-10, and CP2012-11, Request of the United States Postal Service to Add Global Plus 2C to the Competitive Products List and Notice of Filing Two Functionally Equivalent Global Plus 2C Contracts Negotiated Service Agreements and Application for Non-Public Treatment of Materials Filed Under Seal, December 30, 2011.

21 Under the imputed method, revenues for both the Global Plus 2B and 2C products cover attributable costs. *See* Library Reference USPS USPS-FY12-NP2, Excel file Reports .xls (Revised 1-14-13).

with section 3633(a)(2).[22] Moreover, an NSA with the same commercial mailer in each of the three products—Global Plus 2A, 2B and 2C—has failed to cover its attributable costs.[23]

When the Postal Service initially filed with the Commission the NSAs that are the subject of Docket Nos. CP2011-41 and CP2012-10, the Postal Service claimed that each NSA would generate sufficient revenues to cover attributable costs, consistent with section 3633(a)(2). Based upon analysis of the Postal Service's financial models (filed under seal) that estimate the revenues and costs, the Commission preliminarily found that each NSA should cover its attributable costs and otherwise comport with the statutory provisions applicable to rates for competitive products. In light of the FY 2011 and FY 2012 reported results, the Commission concludes that the Postal Service's estimated financial results cannot be presumed to be sufficiently accurate for prospective purposes.

For the Global Plus 2B and 2C products during FY 2012, the Postal Service explains that attributable costs exceeded revenues for outbound Admail™ to Canada.[24] The Postal Service observes that the rate schedules of Canada Post applicable to outbound Admail™ "have detailed structures...that are not able to be explicitly considered in estimating...costs." *Id.* As such, the Postal Service states its cost model is "oversimplified" and therefore the evaluation of outbound Admail™ costs is "less accurate than would otherwise have resulted from a detailed analysis of mail tendered." *Id.* The Postal Service "plans to investigate options for obtaining better data or refining the calculations." *Id.*

The Postal Service has an obligation to negotiate compensatory rates for NSAs and, if necessary, reject NSAs that are not likely to be compensatory at the outset. Moreover, the Postal Service has the option of cancelling existing NSAs when they are not compensatory.

The Commission finds that the Global Plus 2B and Global Plus 2C products did not comply with section 3633(a)(2). In addition, the Commission notes that in FY 2011, the predecessor agreement to Global Plus 2B with the same mailer, Global Plus 2A, also failed to cover attributable costs. The insufficiency of the Postal Service's estimates calls into question the basis of the Commission's recent approval of the Global Plus 2C NSA in Docket No. CP2013-38, the successor to the NSA in Docket No. CP2012-10.

The Commission concludes that the Postal Service must report within 90 days on whether the NSA that is the subject of Docket No. CP2013-38 complies with section 3633(a)(2). The Postal Service's report shall consist of the FY 2013 monthly financial results based upon the financial model previously provided to the Commission with its Notice in Docket No. CP2013-38, updated for actual volumes. *The Commission also directs the Postal Service to*

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22 2011 ACD at 160. In that fiscal year, the Global Plus 2A product consisted of two NSAs and both reported a loss in contribution. One NSA was the predecessor to the NSA that was the subject of Docket No. CP2011-41. *See* Library Reference USPS-FY11-NP2, Excel file NSA Summary (Booked).xls, worksheet tab Summary.

23 It should also be noted that in FY 2011, the Global Plus 2B product also consisted of two NSAs, one of which was the NSA that was the subject of Docket No. CP2011-41. That NSA also reported a loss, although the Global Plus 2B product generated sufficient revenue as a whole to cover attributable costs.

24 Response to CHIR No. 8, question 5. Addressed and Unaddressed Admail™ is a direct mail marketing service of Canada Post for commercial mailers that market products and services to new and existing customers. http://www.canadapost.ca/business/prodserv/mdm/advisor/en/default.asp Global Direct (GD) service from the Postal Service offers customers a price for mail acceptance within the United States and transportation to a foreign country for direct entry with the foreign postal operator.

modify its financial model for Global Plus NSAs to more accurately develop costs, or increase the contingency factor to accommodate costs that cannot be modeled, in order to ensure that negotiated prices can generate sufficient revenues to exceed attributable costs. The Postal Service report shall describe the modifications implemented with respect to the financial model for Global Plus NSAs, and any other modifications in rates or service requirements likely to affect whether the NSA is in compliance with section 3633(a)(2).

Competitive Inbound International Products Consisting of Negotiated Service Agreements

Like competitive outbound international products, competitive inbound international products featuring negotiated rates are classified on the competitive product list under categories. Table VIII-4 below shows the 10 competitive inbound international products organized by category. As with competitive outbound international products, sometimes the category is also the name of the competitive inbound international product.

Table VIII–4—FY 2012 Competitive Inbound International Products Grouped by Category

Category	Product
Inbound International Expedited Services	Inbound International Expedited Services 2 Inbound International Expedited Services 3 Inbound International Expedited Services 4
Inbound Air Parcel Post (at non-UPU rates)	Royal Mail Group Inbound Air Parcel Post Agreement
Inbound Surface Parcel Post (at non-UPU rates)	Canada Post-United States Postal Service Contractual Bilateral Agreement for Inbound Competitive Services
Inbound Competitive Multi-Service Agreements with Foreign Postal Operators 1	(Same)
Inbound Direct Entry Contracts with Customers	(Same)
Inbound Direct Entry Contracts with Foreign Postal Administrations	Inbound Direct Entry Contracts with Foreign Postal Administrations 1
International Business Reply Service Competitive Contracts	IBRS 1 IBRS 3

Source: 39 CFR 3020 subpart A, App. A.

For FY 2012, the Postal Service reports financial results for the above referenced inbound products presented in Table VIII-4, except Inbound Direct Entry Contracts with Customers. *Inbound Air Parcel Post (at non-UPU rates) and the Inbound International Expedited Services 3 product reported revenues that did not cover attributable costs. As a result, both failed to comply with section 3633(a)(2).*

Of the nine competitive inbound international products reporting financial results, the Postal Service separately reports financial results for the 21 NSAs within those nine products. In 19 of 21 NSAs reported revenues covered attributable costs, and two did not.

One of these NSAs, concluded with the China Post Group, comprises the Inbound International Expedited Services 3 product. The other, also with the China Post Group, is part of the Inbound Competitive Multi-Service Agreements with Foreign Postal Operators 1 product. The Commission also reviews the China Post Group NSA within the

Inbound Competitive Multi-Service Agreements with Foreign Postal Operators 1 product for consistency with section 3633(a)(2).[25]

Inbound International Expedited Services 3

The Inbound International Expedited Services 3 product consists of a bilateral agreement with the China Post Group and constitutes a separate product on the competitive product list.[26] For FY 2012, attributable costs exceeded revenues for inbound Express Mail Service (EMS) from China.

The Postal Service notes that for FY 2012, the bilateral agreement with the China Post Group was in effect only for Quarter 1 (October-December 2011) of FY 2012. In that quarter, the Postal Service reports that attributable costs exceeded revenue for inbound EMS from China. Financial results for Quarters 2–4 were reported as part of the Inbound Competitive Multi-Service Agreements with Foreign Postal Operators 1 product pursuant to a renegotiated bilateral agreement with China. For Quarters 2–4, reported revenues also did not cover attributable costs for inbound EMS from China. For the entire fiscal year period, the Postal Service states that revenues decreased between FY 2011 and FY 2012 primarily because of changes in the average weight of an EMS item. Response to CHIR No. 7, question 2(a)-(b).

The Postal Service suggests that a more complete and more up-to-date comparison of the financial results for inbound EMS from China between FY 2011 and FY 2012 would include all four quarters of FY 2012. Combining two products for purposes of analysis, even if the NSAs are with one shipper, is inconsistent with the Commission's task to evaluate each product for compliance with section 3633(a)(2). In this regard, the Commission reviews the FY 2012 financial results of the Inbound International Expedited Service 3 product separately from the results of the renegotiated China Post Group NSA, which is part of the Inbound Competitive Multi-Service Agreements product.

With respect to the Inbound International Expedited Service 3 product, the Commission concludes that revenues during the first quarter of FY 2012 did not exceed attributable costs. Additionally, the China Post Group NSA revenues did not exceed attributable costs for the portion of FY 2012 that it was in effect (Quarters 2–4). Thus, these NSAs were not in compliance with section 3633(a)(2). These results call into question the basis of the Commission's recent approval of the NSA in Docket No. CP2013-23, the successor to the China Post Group NSA.

The Commission concludes that the Postal Service must report within 90 days on whether the successor China Post Group NSA that is the subject of Docket No. CP2013-23 complies with section 3633(a)(2). The Postal Service's report shall consist of the FY 2013 monthly financial results based upon the financial model previously provided to the Commission with its Notice in Docket No. CP2013-23, updated for actual volumes. *The Commission also directs the Postal Service to modify its financial model for the China Post Group NSA to more accurately develop costs, or increase the contingency factor to accommodate costs that cannot be modeled, in order to ensure that negotiated*

[25] *See* footnote 15, *infra*.

[26] *See* Docket Nos. MC2010-13 and CP2010-12, Request to Add Inbound Expedited Services 1 to the Competitive Product List, and Notice of United States Postal Service of Filing China Post Group—United States Postal Service Contractual Bilateral Agreement (Under Seal), November 20, 2009. In approving the Postal Service's request, the Commission designated the new product Inbound International Expedited Services 3. *See* Docket Nos. MC2010-13 and CP 2010-12, Order No. 365, Order Adding Inbound International Expedited Services 3 to the Competitive Product List, December 22, 2009, at 1.

prices can generate sufficient revenues to exceed attributable costs. The Postal Service report shall describe the modifications implemented with respect to the financial model for China Post Group, and any other modifications in rates or service requirements likely to affect whether the NSA is in compliance with section 3633(a)(2).

Inbound Air Parcel Post (at non-UPU rates)

Under the heading Inbound Air Parcel Post (at non-UPU rates), the Postal Service reports financial results for inbound air parcels entered pursuant to the Royal Mail Inbound Air Parcel Post Agreement, which is classified as a product on the competitive product list. The Postal Service also reports financial results collectively from several other European postal operators that are parties to the Agreement for the Delivery of Day-Certain Cross-Border Parcels (EPG agreement). Pursuant to the EPG Agreement, which became effective prior to the PAEA,[27] the Postal Service subsequently concluded separate bilateral agreements for the entry of inbound air parcels with postal operators from Belgium, Denmark, Germany, Finland, Sweden, Switzerland, Slovakia, and Slovenia. 2012 ACR at 41- 42. These agreements are not included on the competitive product list. *Id.* at 42.

For FY 2012, the Postal Service reports a loss of $912,000 for Inbound Air Parcel Post (at non-UPU rates).[28] Revenues from inbound air parcels entered pursuant to the bilateral agreement with Royal Mail covered attributable costs. As a result, the loss is caused solely by the financial results for inbound air parcels from EPG members. The Postal Service states that "inbound rates for EPG air parcels tendered by [EPG-member] posts have not been changed." 2012 ACR at 42. The Postal Service states it is reviewing its obligations under the bilateral agreements with EPG-member countries "to determine if they continue to be in the best interests of the Postal Service." *Id.* In this regard, the Postal Service appears to be giving consideration to the rates applicable to outbound air parcels to EPG member countries that increase overall contribution to the Postal Service. *Id.*

Current rates applicable to inbound air parcels from EPG member countries have not changed, in some cases for many years, and in FY 2012 revenues failed to cover attributable costs. Such inbound air parcel rates appear to be inconsistent with a statutory policy, which requires the United States to "promote and encourage unrestricted and undistorted competition in the provision of international postal services and other international delivery services." 39 U.S.C. 407(a)(2). The Commission considers this situation unacceptable. The continued entry of inbound air parcels at rates that do not cover costs means that domestic mailers are subsidizing the entry of such parcels in competition with private companies engaged in international delivery services.

The Commission concludes that Inbound Air Parcel Post (at non-UPU rates) does not comply with of sections 407(a)(2) and 3633(a)(2). *The Postal Service is directed to file a report within 90 days regarding its plans to improve the financial results for Inbound Air Parcel Post (at non-UPU rates) and its plans to add EPG bilateral agreements to the competitive product list.*

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27 The Postal Service entered into the EPG Agreement on October 17, 2006.

28 *Id.* at 41. In the imputed version of the ICRA, the Postal Service reports an increase in contribution from Inbound Air Parcel Post (at non-UPU rates). Response to CHIR No. 8, question 3.

Appropriate Contribution Provision: Section 3633(a)(3)

Section 3633(a)(3) requires that the Commission ensure that all competitive products collectively cover an appropriate share of the institutional costs of the Postal Service. In implementing section 3633(a)(3), the Commission determined that if competitive products contribute at least 5.5 percent toward the Postal Service's institutional costs, then competitive products, as a whole, cover an appropriate share of the Postal Service's total institutional costs. *See* 39 C.F.R. 3015.7(c).

In FY 2012, the Postal Service reported that total institutional costs were $40.6 billion. Therefore, in order to comply with section 3633(a)(3) for FY 2012, competitive products must contribute at least $2.2 billion toward the Postal Service's institutional costs. As Table VIII-2 shows, in FY 2012, the total competitive products contribution was $3.0 billion, which exceeds the $2.2 billion minimum contribution requirement.[29] *Therefore, the Commission finds that in FY 2012, competitive products satisfied section 3633(a)(3) by covering an appropriate share of the Postal Service's institutional costs.*

Section 3633(b) requires that the Commission review the minimum contribution requirement every five years and determine whether the contribution requirement should be retained in its current form, modified, or eliminated. In FY 2012, the Commission conducted its first review pursuant to section 3633(b). In Order No. 1449, the Commission reaffirmed that the appropriate share of institutional costs to be borne by competitive products is 5.5 percent, subject to future revision, if necessary.[30]

Competitive Market Tests

Section 3641 authorizes the Postal Service to conduct market tests of experimental products. A market test may not be conducted, however, unless each of the following conditions are satisfied:

- The product is significantly different from all products offered by the Postal Service within the two-year period preceding the start of the test (section 3641(b)(1));
- The product will not result in an unfair or inappropriate competitive advantage for the Postal Service or mailers, especially with regard to small business concerns (section 3641(b)(2)); and
- The product is correctly characterized as either market dominant or competitive (section 3641(b)(3)).

In addition, market tests of experimental products may not exceed 24 months (section 3641(d)), or exceed $10 million in annual revenue (section 3641(e)). The Commission may exempt a market test from the $10 million revenue limitation for certain market tests up to a $50 million annual revenue limit (section 3641(e)(2)).

The Gift Cards test was the only competitive market test in effect during FY 2012. Under the market test, customers may purchase two types of gift cards: fixed and variable.[31] Fixed gift cards are available in amounts of $25 or $50.

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29 The Public Representative also concluded that the Postal Service complied with section 3633(a)(3) in FY 2012. *See* PR Comments at 52.

30 Docket No. RM2012-3, Order Reviewing Competitive Products' Appropriate Share Contribution to Institutional Costs, August 23, 2012 at 24-25 (Order No. 1449).

31 Docket No. MT2011-2, Order Authorizing Gift Card Market Test, April 28, 2011 (Order No. 721).

Variable gift cards are available in amounts ranging from $25 to $100.

In FY 2012, the Gift Cards market test earned $1,080,020 in revenue and incurred $278,645 in total costs. 2012 ACR at 45. Thus, the Gifts Cards market test provided a contribution of $801,375 in FY 2012. *The Commission finds that the Gift Cards market test complied with the requirements of sections 3641 and 3633 in FY 2012.*

Competitive Products Fund

The Competitive Products Fund was created by 39 U.S.C. 2011 as part of the PAEA to serve as a repository for competitive products' revenues, returns on investments, and other amounts directly related to the competitive products enterprise. It is a revolving fund and can be used for the payment of expenses attributable to competitive products, capital expenditures on behalf of competitive products, and for contribution to the Postal Service's institutional costs.

The Postal Service has filed all of the competitive products financial statements required by 39 C.F.R. 3060.21 through 3060.24 and 3060.30 as Library Reference USPS-FY12-39.

The Postal Service reported the Competitive Products Fund balance on September 30, 2012 as $1,057 million.[32] Table VIII-5 shows the income and fund balance data for competitive products for FY 2008 through FY 2012.[33]

Table VIII–5— FY 2012 Competitive Products Income and Fund Balance after Payment of Income Tax[1]

Fiscal Year	Investment Interest Income ($000)	Pretax Income After 5.5% Contribution ($000)	Income Tax ($000)	Net Income After Tax ($000)	Balance in Competitive Products Fund ($000)
2008	–	14,385	(4,935)	9,450	9,450
2009	2	368,228	(128,880)	239,348	248,798
2010	198	550,785	(192,775)	358,010	606,808
2011	290	691,131	(241,896)	449,235	1,056,043
2012	516	808,560	(282,996)	525,564	1,581,607

Source: Library References USPS-FY12-39, USPS-FY11-39, USPS-FY10-39, USPS-FY09-39.

[1] Corrections have been made to amounts reported in prior year Annual Compliance Determinations to reconcile to Competitive Products Fund Reporting materials filed annually by the Postal Service.

Unlike prior years, the Postal Service did not file its FY 2012 Federal income tax statement by January 15, 2013, pursuant to 39 C.F.R. 3060.41. Instead, the calculation of income tax is included in its Competitive Products'

[32] Monthly Statement of the Public Debt of the United States, September 30, 2012, at 10, Table 3, http://www.treasurydirect.gov/govt/reports/pd/mspd/2012/opdm092012.pdf and National Trial Balance, September, 2012 (FY2012), November 15, 2012.

[33] Competitive products' share of institutional costs and income tax is determined after the closing of accounting records at the end of each fiscal year. In other words, the Competitive Products Fund balance at the end of FY 2012 should be the same as the cumulative Competitive Products Fund balance at the end of FY 2011. There is an unexplained difference in the balance reported for FY 2012 on the Postal Service National Trial Balance and the calculated cumulative balance reported as Net Income (Loss) After Tax on the Postal Service Proposed Competitive Products Income Statements, filed in this and prior ACR proceedings as Library References USPS-FY-12-39;USPS-FY-11-39; USPS-FY-10-39; USPS-FY-09-39.

Income Statement, a report required by rule 3060.21. In addition, the Competitive Products Fund held within the U.S. Treasury was not listed in Table III-Detail of Treasury Securities Outstanding, January 31, 2013, of the Monthly Statement of Public Debt.

In its response to CHIR No. 8, question 8, the Postal Service states that on October 12, 2012, the balance of the Competitive Products Fund was transferred to the Postal Service Fund "as a prepayment of competitive products' shares of future years' institutional costs" and that the Competitive Products Fund's zero balance was likely the reason why the account was not listed on the Monthly Statement of Public Debt. Response to CHIR No. 8, question 8. The Postal Service also notes that it will meet the requirements of section 2011(a)(2) by transferring funds from the Postal Service Fund to the Competitive Products Fund as necessary. *Id.*

In response to CHIR No. 8, question 9, the Postal Service states that despite the zero balance of the Competitive Products Fund, it made the annual Federal Income Tax transfer in accordance with 39 U.S.C. 3634. The FY 2012 Competitive Products Income Statement shows that total net income from competitive products before tax was $808.6 million. The assumed Federal Income Tax on these earnings was $283 million. The Postal Service states that on January 10, 2013, it transferred $525.6 million representing Net Income After Tax from the Postal Service Fund to the Competitive Products Fund. Response to CHIR No. 8, question 9. The Postal Service reports that on January 11, 2013, it again transferred the balance of the Competitive Products Fund to the Postal Service Fund as a prepayment of competitive products' shares of future years' institutional costs. *Id.*

Commission Analysis

The Postal Service Fund is available to the Postal Service "to carry out the purposes, functions, and powers authorized" [by title 39] (other than any of the purposes, functions, or powers for which the Competitive Products Fund is available.)" 39 U.S.C. 2003(a). More specifically, pursuant to 39 U.S.C. 2003(e)(1), the Postal Service Fund may be used for (1) the payment of expenses incurred by the Postal Service in carrying out its functions, except for those purposes, functions or powers for which the Competitive Products Fund is available; (2) expenses of the Postal Regulatory Commission; and (3) the expenses of the Office of the Inspector General. Pursuant to section 2011(a)(2), the Competitive Products Fund is available for the payment of costs attributable to competitive products and all other costs incurred by the Postal Service, to the extent allocable to competitive products. Lastly, section 3634(b) requires that the annual Federal Income Tax be transferred from the Competitive Products Fund to the Postal Service Fund on or before January 15 of the subsequent fiscal year.

During FY 2012 (and later), the Postal Service transferred amounts from the Postal Service Fund to the Competitive Products Fund. These transfers create issues of first impression related to whether such transfers are consistent with title 39. *See* 39 U.S.C. 2011(h)(2)(C)(ii) and 39 C.F.R. 3060.42. *Because the issues are not ones of compliance, the Commission will, in the near future, initiate a proceeding pursuant to section 2011(h)(2)(C)(ii) to review the transfer of amounts from the Postal Service Fund to the Competitive Products Fund, the use of amounts from the Competitive Products Fund to prepay competitive products' shares of future years' institutional costs, and the accounting and transfer of the assumed Federal Income Tax for FY 2011 and FY 2012. This will give interested persons, including the Secretary of the Treasury, an opportunity to comment on these issues.*

Chapter IX

Nonpostal Services

Introduction

In December 2012, the Commission approved language proposed by the Postal Service describing its authorized nonpostal products and pricing to be included in the Mail Classification Schedule.[1] The Commission approved language for two market dominant nonpostal products and nine competitive nonpostal products. Order No. 1575 at 4. The two market dominant products are: (1) Alliances with the Private Sector to Defray Cost of Key Postal Functions; and (2) Philatelic Sales. *Id.* The nine competitive products are: (1) Advertising; (2) Licensing of Intellectual Property other than Officially Licensed Retail Products (OLRP); (3) Mail Service Promotion; (4) Officially Licensed Retail Products (OLRP); (5) Passport Photo Service; (6) Photocopying Service; (7) Rental, Leasing, Licensing or other Non-Sale Disposition of Tangible Property; (8) Training Facilities and Related Services; and (9) USPS Electronic Postmark (EPM) Program. *Id.* Descriptions of each product have been added to the Mail Classification Schedule. *Id.*

FY 2012 Financial Analysis

39 C.F.R. 3050.21(i) requires that the Postal Service report revenues, volumes, and expenses for nonpostal services. In its FY 2012 ACR, the Postal Service reported financial data for the two market dominant nonpostal products in the public portion of its report. 2012 ACR at 46. The Postal Service reported financial data for the competitive nonpostal products in a non-public annex.[2]

As Table IX-1 shows, in FY 2012, nonpostal services generated $167.1 million in revenue and incurred $39.1 million in expenses, which resulted in a net income of $128.0 million. Although nonpostal services generated a net income of $128.0 million in FY 2012, that figure represents a nine percent decrease compared to FY 2011. *The Postal Service should work to maximize the net income of nonpostal services moving forward.*

1 *See* Docket No. MC2010-24, Order Approving Mail Classification Schedule Descriptions and Prices for Nonpostal Service Products, December 11, 2012 (Order No. 1575). See also Docket No. MC2010-24, Response of United States Postal Service to Order No. 1575 that Provided Details of, and Requested Responses Regarding, MCS Language for Nonpostal Services, December 26, 2012 *and* Docket No. MC2008-1 (Phase IIR), Order Resolving Issues on Remand, April 30, 2012 (Order No. 1326).

2 *See* Library Reference USPS-FY12-NP27, 2012 Competitive NSA and Nonpostal Materials.

Table IX–1—FY 2012 Volume, Revenue, Expense, and Net Income Nonpostal Services

Nonpostal Services	Volume	Revenue	Expense	Net Income
Market Dominant Nonpostal Services				
Alliances with the Private Sector to Defray Costs of Key Postal Functions	NA	$44,956,099	$4,678,334	$40,277,765
Philatelic Sales	263,169	$10,647,495	$6,523,854	$4,123,641
Total Market Dominant Nonpostal Services	263,169	$55,603,594	$11,202,188	$44,401,406
Competitive Nonpostal Services	18,008,023	$111,502,032	$27,923,134	$83,578,898
Total Nonpostal Services	18,271,192	$167,105,626	$39,125,322	$127,980,304

Source: USPS-FY12-NP27.

The nonpublic financial data show that one product, the EPM Program,[3] failed to generate sufficient revenues to cover expenses. *See* Library Reference USPS-FY12-NP27. For the second consecutive year, the EPM Program was not active and had no vendors. *Id.* However, there were expenses associated with maintaining the EPM Program, primarily third-party contract expenses. *Id.* In FY 2013, the Postal Service permanently discontinued the EPM Program. *See* Response to CHIR No. 5, question 11. *The Commission expects the Postal Service to report any expenses associated with maintaining or closing (terminating) the EPM Program in FY 2013 as part of its FY 2013 ACR.*

The Postal Service's elimination of the EPM Program demonstrates that the Postal Service is making an effort to eliminate nonpostal services that do not generate net income.[4] The Commission encourages this practice. However, as discussed above, since the overall net income for nonpostal services decreased compared to FY 2011, *the Commission encourages the Postal Service to find ways to maximize the net incomes from the 10 nonpostal services that it currently offers in FY 2013.*

Future Financial Reporting

In the FY 2011 ACD, the Commission directed the Postal Service to separate nonpostal services from postal services in the CRA, RPW, and billing determinants filed with its ACR. *See* 2011 ACD at 168. However, this year's ACR continued to include Philatelic Sales workhours in the methodology it used to develop the attributable costs for the Stamp Fulfillment Services product. *The Commission directs the Postal Service to separate Philatelic Sales data from Stamp Fulfillment Services data in its FY 2013 ACR.*[5]

For FY 2012, the Commission only required the Postal Service to report revenues, volumes, and expenses for nonpostal services in its ACR. *See* 39 C.F.R. 3050.21(i). However, now that the Commission has approved the Postal Service's proposed MCS language for nonpostal services, "the Commission also may issue a notice of proposed rulemaking requesting comments on appropriate regulations for nonpostal products and, upon review of the comments, may propose additional rules for nonpostal products." Order No. 1575 at 6.

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3 The EPM Program allows vendors to provide their customers with Postal Service-authorized timestamps for the purpose of substantiating at a later time that the original form of the electronic information presented for time-stamping has not been altered. *See* Order No. 1575, Appendix B at 13.

4 This is the second consecutive fiscal year where the Postal Service noted that it has discontinued nonpostal services that were inactive. *See* Library Reference, USPS-FY11-NP27.

5 This issue is further addressed in Chapter VII's discussion of market dominant Special Services.

Appendix A

Empirical Review of Price Cap Application

When the Postal Service adjusts Market Dominant prices, the Commission reviews the proposed set of prices for consistency with title 39. The Commission's rules for modern rate regulation require the use of a backward-weighted volume index (Laspeyres index) for the pre-implementation review of proposed price adjustments for consistency with 39 U.S.C. 3622(d), the statutory price cap. This index is used to calculate the percentage change in prices for each class by using the most recently available historical billing determinants to weight the percentage change of each price cell. The price cap rules further instruct the Postal Service to make reasonable adjustments to the billing determinants to account for classification changes such as the addition, elimination, or redefinition of price categories. See 39 C.F.R. 3010.23. At the time the rules were proposed, several parties expressed concern that this approach might not accurately reflect the actual change in prices. The Commission took note of these concerns and stated its intent to monitor the effectiveness of the rules.[1]

As part of the monitoring process, the Commission included in the FY 2009 ACD and the FY 2010 ACD reviews of the Docket No. R2008-1 and Docket No. R2009-2 price adjustments. These "Appendix A" reviews consist of a comparison of the percentage change in prices for each class weighted using two different sets of billing determinants. The first of these was the historical billing determinants used in the Commission's pre-implementation review (a Laspeyres index), and the second was the billing determinants from the first full year that the prices had been in effect (a forward-weighted, or Paasche, index).

Billing determinants can be thought of as a market basket of purchased postal services. In the Docket No. R2011-2 price adjustments, the CPI cap was applied to the market basket of services purchased in FY 2010. If mailers purchased the exact same services in the full year that the new prices were in effect, then the new prices would produce the projected increases consistent with the price cap. However, factors including the price changes may affect the quantity and mix of purchased services, thus the market basket changes as a result of the new prices and other factors. This analysis uses billing determinants that represent the market basket of purchased services at the new prices.

This year, the Commission performs a similar post-implementation review of the Docket No. R2011-2 price adjustment. Unlike the previous price adjustments, the Docket No. R2011-2 adjustment was not in effect for an

[1] *See* Docket No. RM2007-1, Order No. 26, Order Proposing Regulations to Establish a System of Ratemaking, August 15, 2007, at 33-36.

entire fiscal year.[2] Therefore, the volumes of the three quarters following the implementation of R2011-2 prices (FY2011 Q3 through FY2012 Q1) are used to weight the prices instead of fiscal year volumes. In Docket No. R2011-2 the price cap was 1.741 percent.

Table A-1 presents a comparison of the average price increase for each class from the pre-implementation review with those developed using actual volumes sent at the Docket No. R2011-2 prices.

Table A–1—Percentage Increase in Price by Class

Class	Pre-implementation at Proxy Volumes %	Volumes at R2011-2 Prices %	Difference %	Percent Exceeded Price Cap %
First-Class Mail	1.738	1.875	0.137	0.134
Standard Mail	1.739	1.788	0.049	0.047
Periodicals	1.741	1.762	0.021	0.021
Package Services	1.740	1.697	-0.043	N/A
Special Services	1.739	1.776	0.037	0.035

Source: PRC-ACR2012-LR6.

The analysis using the forward-weighted index shows that all classes except for Package Services exceeded the price cap. The range of price increases using the forward-weighted index was 1.697 to 1.875. At the high end, the First-Class increase was 0.134 percent greater than the CPI cap.

The Docket No. R2011-2 price adjustment included several classification changes, including adjustments to parcel pricing structures in several classes. In FY 2012, several types of parcels were moved from the Market Dominant Product List to the Competitive Product List. Changes in overall volume levels for parcels further complicate the analysis. *See* Docket No. RM2007-1, Order No. 26, Order Proposing Regulations to Establish a System of Ratemaking, August 15, 2007, at 33-36.

It appears the differences shown above primarily reflect continuing patterns of volume shifts within each class. For example, in the pre-implementation volume index, First-Class Mail Single Piece Letters and Cards accounted for about 44 percent of First-Class Mail revenue, compared to about 34 percent of post-implementation revenue. First-Class Mail automation letters account for 44 percent of the pre-implementation revenue and about 54 percent of the post-implementation revenue for the class. Therefore, using the volumes mailed at Docket No. R2011-2 prices as weights, the price increase for automation letters (1.785 percent) accounts for a larger share of the class average increase than it did in the pre-implementation calculation. Similarly, the price increase for single-piece letters (0.36 percent) accounts for a smaller share than it did in the original calculation. Because single-piece and automation

[2] Billing determinants are divided between before and after the implementation date of the Docket No. R2011-2 prices. The Docket No. R2011-2 price adjustment was implemented on April 17, 2011. The R2012-3 adjustment was implemented on January 22, 2012. It is not possible to divide FY 2011 Q3 and FY 2012 Q2 billing determinants between the periods where Docket No. R2011-2 prices were not in effect. A few minor issues with the international billing determinants were resolved as discussed in PRC-ACR2012-LR6.

letters combined make up the majority of First-Class Mail volumes, these volume changes are the primary reason that the average increase is higher when the actual volumes at Docket No. R2011-2 prices are used.

Several unique features of the Docket No. R2011-2 price increase makes it difficult to analyze using a forward-weighted (Paasche) index. First, the prices were not in effect for a full year. This means that seasonal volume patterns may impact the index calculation. Second, the price increase implementation did not line up with fiscal quarters, making the precise measurement of volume mailed at Docket No. R2011-2 prices imprecise. Third, the Docket No. R2011-2 price increase was the first in nearly two years, and major classification changes were made. These classification changes mean that the identification of the proper pre-implementation and post-implementation price categories lacks precision.

The forward-weighted (Paasche) index highlights that, for a given price adjustment, the actual price increase experienced by individual mailers may not perfectly align with the average price increase for the class as calculated prior to implementation. The Postal Service has flexibility within the price cap to implement differential price changes within each class of mail. The forward-weighted (Paasche) index is a valuable tool for assessing how mailer post-implementation experience may differ from pre-implementation experience.

Appendix B

Financial Results Under Previous Classification

This appendix presents Postal Service financial results for FY 2012 using the mail classification system in place prior to the passage of the PAEA. Prior to the PAEA, mail classes were subdivided into subclasses, and the financial reports reflected that organization. The PAEA uses the term product, defined as "a postal service with a distinct cost or market characteristic for which a rate or rates are, or may reasonably be applied." 39 U.S.C. 102(6). Within classes, the Postal Service reports data by product, not by subclass. To facilitate historical comparisons, Table B-1 presents volumes, revenues, attributable costs, and contribution to institutional cost using the former classification scheme of subclasses.

Table B–1—Fiscal Year 2012 Volume, Revenue, Cost and Cost Coverage by Class Previous Classification (Subclasses)

	Volume (000)	Revenue ($000)	Attributable Cost ($000)	Contribution to Institutional Cost ($000)	Rev./Pc. (Cents)	Cost/Pc. (Cents)	Contribution to Institutional Cost/Pc. (Cents)	Cost Coverage
Competitive Mail								
Express Mail	39,823	801,561	467,227	334,334	2,012.806	1,173.256	839.550	171.6%
Priority Mail	824,202	5,939,726	4,545,341	1,394,385	720.664	551.484	169.180	130.7%
Parcel Select and Parcel Return Service (PRS)	984,202	1,456,216	1,105,767	350,450	147.959	112.352	35.608	131.7%
First-Class Package Service	411,424	875,654	766,719	108,935	212.835	186.357	26.478	114.2%
Competitive International Mail	273,525	1,837,317	1,216,598	620,719	671.717	444.784	226.933	151.0%
Competitive Domestic Services		504,824	273,118	231,706				184.8%
Competitive International Services		10,577	8,391	2,187				126.1%
Total Competitive Mail and Services	**2,533,176**	**11,425,875**	**8,383,159**	**3,042,716**	**451.049**	**330.935**	**120.115**	**136.3%**
Market Dominant Mail								
First-Class Mail								
Letters, Flats & Parcels	65,243,270	28,536,156	13,703,057	14,833,099	43.738	21.003	22.735	208.2%
Cards	3,746,446	979,389	511,848	467,541	26.142	13.662	12.480	191.3%
Standard Mail								
Regular	42,341,738	10,226,597	5,514,146	4,712,451	24.153	13.023	11.130	185.5%
Nonprofit	11,004,146	1,509,431	2,734,781	(1,225,350)	13.717	24.852	(11.135)	55.2%
Regular and Nonprofit	**53,345,884**	**11,736,028**	**8,248,927**	**3,487,101**	**22.000**	**15.463**	**6.537**	**142.3%**
Enhanced Carrier Route (ECR)	24,350,847	4,750,192	2,739,450	2,010,742	19.507	11.250	8.257	173.4%
Nonprofit ECR	2,102,934	226,349	228,268	(1,919)	10.763	10.855	(0.091)	99.2%
ECR and NECR	**26,453,780**	**4,976,541**	**2,967,718**	**2,008,822**	**18.812**	**11.219**	**7.594**	**167.7%**
Periodicals								
Within County	631,286	67,269	95,398	(28,129)	10.656	15.112	(4.456)	70.5%
Outside County	6,110,064	**1,664,217**	**2,306,204**	**(641,987)**	**27.237**	37.744	**(10.507)**	**72.2%**
Package Services								
Single-Piece Parcel Post	70,971	774,438	840,359	(65,921)	1,091.206	1,184.092	(92.885)	92.2%
Bound Printed Matter	473,829	493,537	419,454	74,084	104.159	88.524	15.635	117.7%
Media Mail	93,771	301,412			321.434			
Library Rate	6,651	19,834			298.213			
Media and Library Mail	**100,422**	**321,246**	**376,770**	**(55,524)**	**319.896**	**375.187**	**(55.291)**	**85.3%**
U.S. Postal Service Mail	440,452							
Free Mail	56,952		39,586	(39,586)		69.507		
Market Dominant International Mail	652,322	939,551	795,510	144,041	144.032	121.950	22.081	118.1%
Total Market Dominant Mail	**157,325,678**	**50,488,371**	**30,304,830**	**20,183,541**	**32.092**	**19.262**	**12.829**	**166.6%**

Table B–1—Fiscal Year 2012 Volume, Revenue, Cost and Cost Coverage by Class Previous Classification (Subclasses)—Continued

	Volume (000)	Revenue ($000)	Attributable Cost ($000)	Contribution to Institutional Cost ($000)	Rev./Pc. (Cents)	Cost/Pc. (Cents)	Contribution to Institutional Cost/Pc. (Cents)	Cost Coverage
Market Dominant Services								
Certified Mail		662,806	601,869	60,937				110.1%
COD		5,927	3,604	2,323				164.5%
Insurance		108,510	96,969	11,541				111.9%
Registered Mail		39,477	30,226	9,251				130.6%
Stamped Envelopes		16,584	6,389	10,196				259.6%
Stamped Cards		2,117	731	1,386				289.6%
Money Orders		165,093	110,474	54,619				149.4%
Post Office Box Service		481,567	377,073	104,493				127.7%
Caller Service		92,490	27,045	65,445				
Other Special Services		730,588	562,936	167,652				129.8%
International Services		29,435	22,763	6,672				
Other Income		927,529		927,529				
Total Mail and Services	**159,858,854**	**65,176,370**	**40,528,068**	**24,648,302**	**40.771**	**25.352**	**15.419**	**160.8%**
Institutional Costs			40,625,129					
Appropriations: Revenue Forgone		46,204						
Investment Income		24,657						
Total Revenues		65,247,231						
Total Costs			81,153,198					
Net Income (Loss)		(15,905,966)						

Source: Library Reference PRC-ACR2012-LR1

Appendix C

Methodology Changes and Management Operating Data System

Introduction

In FY 2012, the Postal Service filed five petitions to change analytical principles relating to its periodic reports.[1] A summary of the proposed changes to the analytical principles, and the Commission's analysis are discussed below. This appendix contains three parts: (1) a summary of the methodological changes, (2) a list of analytical principle changes the Postal Service is expected to undertake and (3) a discussion of the Postal Service's Management Operating Data System (MODS).

Methodology Changes

RM2012-1 Proposal Nine: Change in Method of Distributing the Domestic Transportation Costs of Foreign Origin (Inbound) Letter Post Mail

The Postal Service proposed to change the current method for distributing the domestic transportation costs of inbound letter post to countries and the country group reporting categories presented in the International Cost and Revenue Analysis (ICRA) report. In the past, the method for distributing the domestic transportation costs (Cost Segment 14) of inbound letter post was based upon the number of pieces entered from each country or country group. Under Proposal Nine, domestic transportation costs would be distributed based upon weight. The Postal Service believes that distributing the domestic transportation costs of inbound letter post based upon weight offers the following advantages over the previous methodology:

- It would be consistent with the distribution of such costs for U.S. origin (outbound) letter post, which has been presented in the ICRA report by country or country group; and
- Distributing domestic transportation costs based upon weight recognizes the significant variation in weight per piece across countries and country groups.

The Postal Service noted in its analysis submitted with Proposal Nine, that the most significant impact was a reduction in the cost of inbound letter post from Canada "because, on average, this mail is significantly less per piece than inbound mail from the rest of the world."[2]

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[1] In FY 2012, all proposes to change analytical principles to periodic report proposals initiated were completed prior to the Postal Service's FY 2012 ACR filing except for Proposal Nine in Docket No. RM2012-8. Proposal Nine was approved on February 14, 2013. *See* Order 1656.

[2] Petition of the United States Postal Service Requesting Initiation of a Proceeding to Consider Proposed Changes in Analytical Principles (Proposals Nine – Fifteen), November 1, 2011 (Petition) at 4.

The Commission approved Proposal Nine because it represents an improvement over the previous method by providing a more accurate distribution of transportation costs for inbound letter post. See Order No. 1153. The Postal Service implemented this change in the FY 2012 ACR.

RM2012-1 Proposal Twelve[3]: Modification of the Standard Mail Presort Letters Mail Processing Cost Model

The Postal Service proposed to disaggregate the avoided cost estimates for nonautomation machinable Mixed Automated Area Distribution Center (MAADC) and Automated Area Distribution Center (AADC) presort Standard Mail letters as directed in the 2010 Annual Compliance Determination. To integrate the distinction between nonautomation machinable MAADC and AADC presort letters, the Postal Service created a separate mail flow model for each presort level.[4] The Postal Service also proposed removing MODS data used to calculate piggyback factors for mail processing bar code sorters since these machines are now retired and the piggybank factors are no longer needed.

The Commission approved Proposal Twelve. *See* Order 1153. The Postal Service implemented it in the FY 2012 ACR. Although the Commission approved this proposal, it expressed concerns about the potential implications of Proposal Seventeen (letter automation productivity changes) filed in Docket No. RM2012-2. In previous Annual Compliance Reports (ACR) and rate adjustments, the avoided costs estimate for nonautomation machinable MAADC and AADC presort letters was the same because they were averaged together. Therefore, no passthrough had been calculated for each separate discount and each discount could not be assessed individually. With the approval of Proposal Twelve, separate passthroughs can be calculated.

RM2012-1 Proposal Thirteen: Development of a New Mail Processing Cost Model for Media Mail/Library Mail

The Postal Service presented new mail processing cost models for Media Mail and Library Mail in response to the Commission's directive in Docket No. RM2011-5. With Order No. 724 in Docket No. RM2011-5, the Commission directed the Postal Service to revise its mail processing cost model to utilize the cost pool classification method established in Docket No. R2006-1 for First-Class Mail letters. See Docket No. RM2011-5, Proposal Twelve.

Previously, the Media Mail/Library Mail cost pools were grouped into two categories: workshare proportional or workshare fixed. Under Proposal Thirteen, the cost pools would be grouped into three categories. These are: (1) parcel sorting cost pools classified as workshare proportional; (2) Forwarding/Accepting/Customer service cost pools classified as workshare fixed; and (3) the remaining cost pools (mainly allied, support, and unexpected costs) are piggybacked (distributed) in the ratio of the proportional and fixed cost pools.

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3 Docket No. RM2012-1 proposal numbers are not listed consecutively here because the Commission discussed Proposals Ten and Eleven in the FY 2011 ACD. FY 2011 ACD at 182.
The Commission's rules require the Postal Service's ACR to use the established methodology at the time of filing. For proposals still pending before the Commission at the time of filing an ACR, the Postal Service typically provides two versions of its ACR cost models, the established methodology and the recently proposed methodology. However, for Proposals Ten and Eleven, the Postal Service stated that it was unable to provide both versions, and incorporated only the proposed methodologies in its 2011 ACR filings. The Commission made a limited exception to its rules in this case because the proposals were minor.

4 The MADDC cost model treats outgoing ISS as the first operation. The ADDC cost model treats incoming ISS as the first operation.

Because the proposal creates consistency between parcel cost models and more accurate unit costs, the Commission approved Proposal Thirteen. *See* Order 1153. The Postal Service implemented it in the FY 2012 ACR.

RM2012-1 Proposal Fourteen: Changes in Special Services Cost Models

The Postal Service proposed to modify and update the cost models of a number of Special Services by including costs associated with mail processing and certain retail window-related activities. It proposed to update cost models for the following: Caller Service; Certificate of Mailing; Correction of Mailing List; Periodical Application; P.O. Box Key and Lock; Restricted Delivery; Signature Confirmation; and Zip Coding of Mailing List. To be consistent with the existing CRA methodology, the Postal Service proposed updating each of these cost models to include the Waiting Time Adjustment Factor,[5] the Miscellaneous Factor[6] for window-related activities, and the Miscellaneous Factor for mail processing-related activities.

The Postal Service's data systems do not provide sufficient detail to accurately develop the attributable cost for each of the Special Services. To facilitate analysis, the Postal Service estimates the attributable cost of each service using a cost model that builds up a CRA-type cost. The previous models did not include waiting time cost, window-related cost, or related mail processing cost. The Postal Service reports that these Special Services cost models are needed to disaggregate costs for analysis, since the product volumes and costs are too small for the CRA model to accurately develop them. It explains that these cost models are used to supplement the cost information provided in the Cost and Revenue Analysis (CRA) report.

The Commission approved Proposal Fourteen because, without these costs, the models would not produce a cost comparable to the attributable costs reported for certain ancillary services and would improperly understate the costs of such services. *See* Order 1153. The Postal Service implemented this change in the FY 2012 ACR.

RM2012-1 Proposal Fifteen: Proposed Changes in Cost Models Related to Return Receipt Service

The Postal Service proposed to modify and update four[7] cost models related to Return Receipt service to better reflect current postal operations. This proposal updates each Return Receipt cost model to incorporate costs that were currently reported in the CRA report, but were not identified in each cost model.

Return Receipt provides the sender with proof that the mailpiece was delivered. Since Return Receipt is generally purchased with Certified Mail, the Postal Service proposed measuring the transaction time associated with a Return Receipt by comparing the transaction time difference for a Certified Mail purchase both with, and without, a Return Receipt. After completing the study, the Postal Service estimated the window acceptance time for a Return Receipt to be 0.64 minutes. In addition to the acceptance and delivery transaction times, the Postal Service observed that a clearing clerk reviews the Green Card after it is brought back to the station by carriers and before

[5] The Waiting Time Adjustment Factor reflects the time a postal clerk waits for the customer at the front of the line to walk to the counter.

[6] "The Miscellaneous Factors adjust the transaction costs to allocate clerks' clocking-in and clocking-out time, taking personal breaks, moving equipment, and similar activities." Petition at 19.

[7] Currently, there are four Return Receipt cost models: (1) the traditional Return Receipt (PS Form 3811-the "Green Card"); (2) electronic Return Receipt (eRR); (3) Return Receipt after Mailing; and (4) Return Receipt for Merchandise. Except for Return Receipt for Merchandise, Return Receipt is a Special Service that can be purchased for Express Mail or in combination with another special service such as Certified Mail.

it is mailed back to the customer. With this updated information, the Postal Service revised the traditional Green Card cost model and each of the other three Return Receipt cost models. Specific updates to these three models are discussed below.

Electronic Return Receipt (eRR) provides proof of delivery via an e-mail with the delivery date, time, and a digital image of the signature from the mailpiece. No printed Return Receipt Green Card is sent to the customer. Printing costs for the Green Card were inadvertently included in the existing cost model. Also, the Postal Service proposed adding a Waiting Time Adjustment Factor and the Miscellaneous Factor (window overhead) to the window activity costs.

Return Receipt after Mailing provides the sender with a return receipt showing the date of delivery and the name of the person or organization that received the item, but not an actual signature. The Postal Service proposed adding to the cost model the Waiting Time Adjustment Factor and the Miscellaneous Factor (window overhead).

Return Receipt for Merchandise (PS Form 3804) provides the sender with a mailing receipt and a Green Card. After delivery, the Green Card is returned through the mail to the sender. When the model was initially developed, the costs included only one label – the mailing receipt. As a result, the Postal Service proposed to include the material costs for a Green Card into the model. In addition, the Postal Service reviewed the time needed to collect a customer's signature and found that it was less than what was originally estimated. The Postal Service proposed to update the cost model to reflect the new information. The overall impact of the update is a net decrease in the unit cost for Return Receipt for Merchandise.

Because the proposed updates to the Return Receipt cost models reflect current postal operations, which should be incorporated into the Postal Services costing procedures, the Commission approved Proposal Fifteen. The Postal Service implemented this change in the FY 2012 ACR. *See* Order 1153. A Commission review of the individual Return Receipt cost models also found that the Postal Service had not previously included costs for the Waiting Time Adjustment Factor or the Miscellaneous Factor (window overhead). Because the study was not based on a probability sample, the Commission encouraged the Postal Service to strive in the future to base estimates on probability samples when the budget permits, and to consider the efficacy of using judgment samples only when there are insufficient funds to support a proper sample.

RM2012-2 Proposal Sixteen: Productivity Measurement for Flats Sequencing System

The Postal Service introduced a new method for measuring the productivity of Flats Sequencing System (FSS) operations based upon Management Operating Data System (MODS) data. Since the FSS was fully deployed in FY 2011, the Postal Service proposed to incorporate FSS data into its flats mail processing cost models. Data on the productivity of the two major FSS components: Stand-Alone Mail Prep (MODS operation 530) and the FSS sorter (MODS operation 538) would be used. The numerator of this productivity measurement would consist of the first-pass sort machine count of Total Pieces Fed (TPF) in the FSS sort operation (MODS operation 538). The denominator of this productivity measurement would consist of the sum of the FSS work hours logged for the prep operation (operation 530) and the sorting operation (operation 538). Unlike other productivity measurements (TPF per hour), the FSS productivity also includes the prep work hours in the denominator.

Because the proposal better aligns the flats cost models with operations in the new FSS environment, the Commission approved Proposal Sixteen. *See* Order 1383. The Postal Service implemented this change in the FY 2012 ACR.

RM2012-2 Proposal Seventeen: Consolidated MODS Operation Groups for Letter Automation Productivities

The Postal Service proposed to consolidate MODS operation groups associated with the productivity calculations for the DBCS/DIOSS automated letter image reading and sorting operations. This change responds to changes in the definition of certain MODS operations. The Postal Service explained that the changes to MODS operations definitions were put in place "to promote more accurate use of a streamlined set of operation numbers."[8] The Postal Service further explained: "Since it is costly to have employees re-clock promptly for every change of work activity that may be represented by a distinct MODS operation number, in practice there is a tradeoff between MODS data granularity and accuracy."[9]

In Proposal Seventeen, the Input Subsystem (ISS) and Output Subsystem (OSS) were merged into specific Incoming and Outgoing Barcode Sorting (BCS) operation groups. The Postal Service explained that these consolidations were appropriate because the machines use multimode processing, which merge the ISS/OCR (Optical Character Recognition) and OSS functions. This proposal also modified the First-Class Mail and Standard Mail letter mailflow models that used the previously disaggregated ISS and OSS productivity data, to now use the consolidated BCS operation groups.

Because the proposal modifies the productivities to better align with operational realities, the Commission approved Proposal Seventeen. The Postal Service implemented it in the FY 2012 ACR. *See* Order 1383.

RM2012-2 Proposal Eighteen: Four Modifications to the Flats Cost Models

Proposal Eighteen included four distinct modifications to the flats cost models, each is discussed below.

Proposal Eighteen (Modification One)

Modification One incorporates FSS processing costs into the First-Class Mail, Standard Mail, and Periodicals flats cost models. In appended comments to Time Inc.'s submission, Halstein Stralberg suggested a modification to reclassify the Network Distribution (NDC) FSS cost pool as piece-related sorting. The Postal Service did not oppose this change to their Modification One proposal.

8 Petition of the United States Postal Service Requesting Initiation of a Proceeding to Consider Proposed Changes in Analytical Principles (Proposals Sixteen -- Twenty), November 30, 2011 at 5.

9 Responses of the United States Postal Service to Questions 1-9 of CHIR No. 1, question 7, January 10, 2012.

The Commission approved proposed Modification One to include FSS cost in the flats cost models for First-Class Mail, Standard Mail, and Periodicals. Because the FSS is used to sort mail, it is sensible to treat the cost pool as piece-related. Therefore, the Commission also approved Stralberg's proposal. *See* Order 1383. Concerns about the use of proxy data were resolved when the Postal Service replaced most of the proxy data with operational data in the FY 2011 ACR.

As a first step, the Commission found that the Postal Service's overall approach of incorporating FSS-specific data into the flats mail processing cost models is appropriate. The Commission expressed concern related to the discrepancy between the FSS TPF and TPH, which indicates a relatively low acceptance rate. The Postal Service believes the TPF and TPH difference is a short-run problem and should improve over time. The Commission encouraged the Postal Service to monitor the data and to make improvements as necessary so that the mailflow models accurately reflect the actual FSS operations.

Proposal Eighteen (Modification Two)

Modification Two corrects an anomalous difference in costs between Mixed Area Distribution Center (MADC) automation flats and Area Distribution Center (ADC) automation flats in the First-Class Mail, the Standard Mail, and Periodicals flats cost models. At the time of the Proposal, the costs of MADC presorted flats were estimated to be less than the costs of ADC flats that receive more mailer presorting. Modification Two was approved by the Commission because it mitigates the effect of including single-piece mail in the downflow densities. The proposed change is also consistent with the methodology for First-Class Mail letters approved in Docket No. RM2011-5. Proposal Eighteen, Modification Two was approved by the Commission and implemented in the FY 2012 ACR. *See* Order 1383.

Proposal Eighteen (Modification Three)

Modification Three corrects an error in the calculation of the cost of mechanized ADC pallet bundle sortation in the Periodicals flats cost models. Previous versions of the Periodicals flat worksharing cost avoidance models included an error in the calculation of the ADC pallet mechanized bundle sortation in the flats cost models. The Postal Service provided a corrected cell reference as part of Modification Three.

Because the proposal corrected a calculation error, the Commission approved Proposal Eighteen, Modification Three. *See* Order 1383. The Postal Service implemented it in the FY 2012 ACR.

Proposal Eighteen (Modification Four)

Modification Four modifies the Periodicals flats cost model to include an estimate for the costs of bundles entered on MADC pallets. The Postal Service proposed to use destination-entered ADC pallets as a proxy for origin-entered MADC pallets because no data are currently available for MADC pallets. As further rationale for the use of this proxy, the Postal Service stated that bundles entered on MADC pallets will be processed in the same operations as bundles entered on ADC pallets.

Because use of the ADC proxy is appropriate at this juncture as Mixed ADC pallets are likely to be processed in a similar manner as an ADC pallet,[10] the Commission approved Proposal Eighteen, Modification Four. *See* Order 1383. The Postal Service implemented it in the FY 2012 ACR.

RM2012-2 Proposal Nineteen: Modification of the First-Class Mail Presort Letters Mail Processing Cost Model

The Postal Service proposed to develop separate cost estimates for the nonautomation machinable MAADC and AADC First-Class Mail presort letters. This proposed methodological change is consistent with Proposal Twelve, presented in Docket No. RM2012-1, in which the Postal Service disaggregated the cost estimates for nonautomation machinable MAADC and AADC Standard Mail presort letters. The Commission approved this proposal because it paralleled the recent modification to the Standard Mail presort letters cost model approved by the Commission in Order No. 1153.[11] *See* Order 1383. The Postal Service implemented it the FY 2012 ACR.

RM2012-2 Proposal Twenty: Modification of the Business Reply Mail Cost Model

The Postal Service proposed to update data in the Qualified Business Reply Model (QBRM) avoidable cost model and update and revise the productivity estimates used in the BRM fee cost studies. In the FY 2011 ACD, the Commission reiterated its concern that the QBRM avoided costs may be understated. The Postal Service asserts that the decrease in the QBRM worksharing-related savings estimate is due to the improvement of the Remote Computer Read finalization rate.

The Commission observed that the history of the QBRM cost avoidance model shows that the Postal Service has varied the number of processing operations and whether manual sortation should be incorporated. Based on the Postal Service's response to CHIR No. 3, question 4 and its reply comments in Docket RM2012-2, the Commission concluded that the current cost avoidance model should be modified to include all applicable processing operations and manual sortation.

The Commission also approved the continued use of the current QBRM cost avoidance model with a modification that includes manual sortation but advised the Postal Service to refine the model to include all the processing steps that replies to low volume recipients incur. Additionally, the Commission approved the updated model for calculating QBRM fees because it better reflects operational reality and uses the most recent available data. *See* Order 1383. The Postal Service implemented Proposal Twenty in the FY 2012 ACR.

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[10] "The operational flow provided by the Postal Service in this docket indicates that a Mixed ADC pallet will be opened and worked at an Origin ADC. This is a rational approach that leads to an estimated cost for Mixed ADC pallets entered at an Origin ADC that is lower than the estimated cost for Mixed ADC pallets entered at Origin SCFs. The Postal Service should ensure that this operational flow reflects reality as the Postal Service gains experience with real world processing of Periodicals Mixed ADC pallets." *See* Order 1383 at 19.

[11] *See* Docket No. RM2012-1, Proposal Twelve.

RM2012-5: Proposal One: Elimination of Separate Delivery Costs for Carrier Route Letters, Flats, and Parcels

The Postal Service proposed to end the separate, shape-based reporting of unit delivery costs within Standard Mail Carrier Route in the Cost and Revenue Analysis (CRA) report. In the 2011 ACD, the Commission suggested the "Postal Service may elect to initiate a rulemaking …[to] aggregate Carrier Route letter cost data with Carrier Route flat data" to improve the reliability of Carrier Route unit letter delivery costs.[12] The proposed FY 2012 aggregated unit delivery cost would be the sum of the piggybacked, direct and indirect, city and rural carrier in-office and delivery costs, divided by the sum of Standard Carrier Route letters, flats, and parcels. This would be the same as a volume-weighted average of the unit delivery costs of Carrier Route mail by shape. Because the unit delivery costs for Carrier Route letters and parcels exhibit similar year-to-year volatility and because Carrier Route letters and parcels represent only 1 percent of the volume, it's expected that using the weighted average should eliminate the year-to-year volatility and produce unit delivery costs more representative of the entire carrier route category. For these reasons, the Commission approved Proposal One. *See* Order 1462. The Postal Service implemented it in its FY 2012 ACR.

RM2012-5: Proposal Two: Calculation of City Carrier Scanning Costs for All Non-Accountable Delivery Scans

The Postal Service proposed to extend an existing costing methodology to: (1) the costs of USPS Tracking Barcode delivery scans performed by city carriers during street activities (cost segment 7); and (2) the costs of all non-accountable delivery scans performed by city carriers during street activities. This new USPS Tracking Barcode system allows the Postal Service to track the flow of parcels to the point of delivery. The Postal Service proposed to extend the existing methodology for calculating city carrier street scanning costs to all non-accountable delivery scans performed by the carriers on the street. The proposed methodology for developing the costs of scans performed by city carriers using the USPS Tracking Barcode establishes the foundation for accurately capturing the costs of scanning parcels and the costs of other non-accountable delivery scans that may occur in the future. The previous methodology had not properly assigned scanning costs to the products which incur them. This proposal rectified this issue and is expected to produce more accurate costs. For these reasons, the Commission approved Proposal Two and the Postal Service implemented it in the FY 2012 ACR. *See* Order 1462.

RM2012-5: Proposal Three: Changes in IOCS Encirclement Rules

The Postal Service proposed to update encirclement rules[13] for Inbound International Registered Mail and for certain other extra services to reflect changes in operations and to correct inconsistencies. For Collect on Delivery (COD), Certified, Insured, and Signature Confirmation Extra Services, encirclement would be added for certain mail processing and window operations. Because the proposal more accurately reflects the processing of International Inbound Registered Mail, the Commission approved Proposal Three and the Postal Service implemented it in the FY 2012 ACR. *See* Order 1462.

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[12] 2011 ACD at 121.

[13] "In the [IOCS], encirclement is the process of assigning the cost of handling a mailpiece with an Extra Service to the Extra Service rather than the host mailpiece. Encirclement is warranted when an Extra Service is the primary reason that an employee has to handle a mailpiece." Petition of the United States Postal Service Requesting Initiation of a Proceeding to Consider Proposed Changes in Analytical Principles (Proposals One – Five), June 26, 2012 at 7.

RM2012-5: Proposal Four: Changes in IOCS Reporting Codes

The Postal Service proposed to: (1) streamline In-Office Cost System (IOCS) activity codes by eliminating codes that were no longer used for costing; (2) combine the operation codes for Outgoing Primary Distribution and Outgoing Secondary Distribution into one code; (3) add a code for Managed Mail Distribution; and (4) add new activity codes for Parcel Select Lightweight and revise the codes for First-Class Mail parcels and irregular parcels and pieces. The Commission agreed with the Postal Service that the activity codes to be eliminated were more detailed than needed, and were not currently used in the CRA. The Commission also found that these changes did not have any impact on the calculation of cost distribution keys in the IOCS. The Commission also concurred with the Postal Service that combining the Outgoing Primary and Outgoing Secondary distribution codes into a single Outgoing Distribution in the IOCS should not have an impact on the costs of products. For these reasons, the Commission approved Proposal Four and the Postal Service implemented it in the FY 2012 ACR. *See* Order 1462.

RM2012-5: Proposal Five: Changes to the Methodology of Distributins Costs Incurred by Vehicle Service Drivers

The Postal Service proposed to create a new distribution key for allocating the attributable costs of Vehicle Service Drivers (VSD) (cost segment 8). The new distribution key is derived from a new statistical subsystem of the Transportation Cost System (TRACS) called TRACS-VSD. The Postal Service has developed a sampling frame that enables the development of a continuous statistical system similar to the TRACS highway subsystem. Like the TRACS statistical system, TRACS-VSD will produce quarterly distribution keys to distribute VSD costs. Similar to the TRACS statistical system, the TRACS-VSD subsystem is a stratified multistage sampling system. The Commission concluded that the new methodology reflected the appropriate relative use of VSD transportation by different products. The Commission found that the VSD distribution key, calculated using the new methodology, is a significant improvement over the use of a proxy distribution key. For these reasons, the Commission approved Proposal Five and the Postal Service implemented it in the FY 2012 ACR. *See* Order 1462.

RM2012-7 Proposal Six: Use of the Foreign Postal Settlement System for Reporting of Inbound International Revenue, Pieces and Weight in the International Cost and Revenue Analysis

The Postal Service proposed to use the Foreign Postal Settlement (FPS) system as the sole source for the reporting of inbound international revenue, pieces, and weight in the International Cost and Revenue Analysis (ICRA) report. The FPS system compiles volume and weight data on inbound mail from actual transaction billing documents and electronic messaging provided by foreign postal administrations.

The Commission agreed with the Postal Service that this proposal would improve consistency among the Imputed and Booked versions of the ICRA, the RPW, and the Postal Service's financial statements. Convergence of the imputed and booked revenue had not been achieved at the time of the 2012 ACR filing. Revenue was not the same as the revenue in the FY 2012 RPW report. The Postal Service stated FY 2012 is a "transition year to integrate the first full year of FPS data as used in RPW into the ICRA."[14] The Commission approved Proposal Six. *See* Order 1516.

14 Responses of the United States Postal Service to Questions 1-10 of Chairman's Information Request No. 1, September 21, 2012.

RM2012-7 Proposal Seven: Use of Actual Cubic-Foot Measurements of Parcels in the Transportation Cost System Highway Subsystem

The Postal Service proposed to replace the current, study-based parcel densities in the Transportation Cost System (TRACS) Highway Subsystem with parcel dimensional data now regularly captured in TRACS-Highway tests. Under the proposed methodology, the estimated cubic measurements of sampled parcels would be replaced with actual parcel dimensional measurements. Beginning in Quarter 1 of FY 2012, the TRACS-Highway Subsystem began utilizing actual, measured length, width, and height information for parcel-shaped pieces. As a result, the cubic-foot component of the cubic-foot-miles distribution key for parcels can be determined directly from the product of the three dimensions. These direct measurements eliminated the need for density study information and periodic study updates for parcels. For the subset of parcels identified as irregular in shape, the Origin-Destination System and Revenue, Pieces, and Weight factor of 0.785 would be applied.[15] For the small portion of sampled parcels without useable dimensional information, a smoothed, composite, four-quarter density ratio would be developed, by major mail category, to convert sampled weight measures to cubic-foot measures. Because the proposal would improve the accuracy of costs, the Commission approved Proposal Seven and the Postal Service implemented it in the FY 2012 ACR. *See* Order 1516.

RM2012-8 Proposal Eight: Incorporation of the Lightweight Parcel Select Price Categories into the Parcel Select/Parcel Return Service Mail Processing Cost Model

The Postal Service proposed to move the machinable and irregular cost worksheets contained in the Standard Mail parcel mail processing cost model to the Parcel Select/Parcel Return Service mail processing cost model and relabel the worksheets as "Lightweight Parcel Select." In Docket No. MC2010-36, the Commission conditionally approved the transfer of the commercial Standard Mail machinable and irregular parcels from the market dominant product list to the competitive product list as "Lightweight Parcel Select." Therefore, The Postal Service reasoned that costs reported for FY 2012 should reflect the incorporation of Lightweight Parcel Select into Parcel Select. The Postal Service also proposed using the cost estimates generated by the Parcel Select and Lightweight Parcel Select models to de-average the estimates of mail processing cost by shape for all Parcel Select mailpieces in the FY 2012 Annual Compliance Report.

Because the change to the cost model reflects the transfer of Lightweight Parcel Select to Parcel Select, the Commission approved Proposal Eight and the Postal Service implemented it in the FY 2012 ACR. *See* Order 1567.

[15] The derivation and use of the 0.785 factor is described in Docket No. R2006-1, Direct Testimony of Thomas M. Scherer on Behalf of the United States Postal Service, USPS-T-33, May 3, 2006, at 21-26.

RM2012-8 Proposal Nine: Modification to First-Class Mail, Standard Mail, and Periodicals Flats Cost Models

In Proposal Nine, the Postal Service proposed to make eight distinct modifications to the Periodicals Flats Model and apply four of those modifications to First-Class Mail and Standard Mail Flats Models. Where Proposal Nine affects materials filed in this Report, the Postal Service has generally prepared two versions of the materials, one incorporating the proposal and one not incorporating it.

Proposal Nine's eight modifications are discussed below.

Modifications One and Two are corrections to the Flats models. Modification One removes the ability to isolate (via toggle switches) the effect of individual changes proposed in Docket No. RM2012-2. It renames a tab in the spreadsheet and does not change any calculations within the models. This modification affects the First-Class Mail, Standard Mail, and Periodicals Flats Models. The Commission accepted this modification, as it improved the organization of the Flats Models. Modification Two corrects what the Postal Service describes as "cell referencing errors" in the Periodicals cost model. With Modification Two, the Postal Service corrected cell references that incorporate bundle-related FSS costs. The Commission accepted Modification Two as it harmonized the cell reference with the source explanation.

Modification Three modifies the modeled mail flow used to estimate the number of rejects for the Automated Flats Sorting Machine (AFSM 100). This affects the Flats Models for First-Class Mail, Standard Mail, and Periodicals Mail, making reject rates more consistent with those reported in the MODS data. The Postal Service proposed to account for more sources of rejects in the Flats Models and to adjust automation reject rates to make them consistent with MODS data. The data suggest that the existing model overstates the AFSM 100 and FSS acceptance rates.[16] The Commission found that this modification better reflected current operations, thus improving the accuracy of the current cost models' estimates. However, since less than 5 percent of First-Class flats volume[17] and 17 percent of Standard Mail and Periodicals flats volume were sorted on an FSS[18] the Commission notes that the impact of this modification on worksharing cost avoidances may need to be reviewed as the flats processing operations evolve to optimize use of the FSS.

Modification Four accounts for changes in allied operations resulting from the introduction of the AFSM 100 and FSS and only applies to the Periodicals cost model. The Postal Service incorporated additional allied operations into the Periodicals model and updated the volume of mail flowing between piece-sorting operations. The previous methodology for Periodicals allied flows was designed before deployment of the current generation of flats sorting machines, the AFSM 100 and FSS. The newer technologies have additional allied activities between processing operations and have changed the percentage of volumes that flow between processing operations. Thus, the

[16] At the time, the accept rate for the FSS was 98.16 percent. With the acceptance of Modification Three, it became 89.39 percent. *See* Library Reference USPS-LR-RM2012-8/1, Excel file "FCM.Prsrt.Flats.1023.xls," sheet "ACCEPT RATES," cells G24 and K24.

[17] Library Reference USPS-LR-RM2012-8/1, Excel file "FCM.Prsrt.Flats.1023.xls," sheet "COVERAGE FACTORS", cell L77.

[18] Library Reference USPS-LR-RM2012-8/1, Excel file "PER.OC.Flats.0915.xls", sheet "FSS Parameters", cell L6; *id*., Excel file "Std.Flats.MP.0915.xls", sheet "COVERAGE FACTORS", cell L77. 9.7 percent of non-HD and Saturation flat-shaped volume was processed on the FSS in FY 2011. 16.8 percent of non-HD and Saturation flat-shaped volume was processed on the FSS in FY 2012.

Postal Service believes this modification aligns the Periodical cost model with current operations. The updating of volume flows between operations included in Modification Four increased modeled allied piece-handling costs. The increase in allied operation costs had two impacts. First, it caused the CRA adjustment factor to decrease. Second, that decrease in turn led to a decrease in the total adjusted modeled costs for direct piece operations, as well as for bundle- and container-related costs.

The Commission approved Modification Four because the updated allied flows improve the accuracy of the modeled Periodicals piece cost.

In Modification Five, the Postal Service proposed to use cost data to calculate FSS coverage factors. Previous versions of the First-Class Mail, Standard Mail, and Periodicals Flats Models assumed that FSS coverage factors were the same for First-Class Mail, Standard Mail, and Periodicals. However, the Postal Service states that this coverage factor does vary by class. Therefore, the Postal Service proposed to use cost estimates to distribute MODS FSS TPF to each class and generate class-specific coverage factors as the ratio of distributed MODS FSS TPF to eligible Revenue, Pieces, and Weight volume.

The Commission approved Modification Five, as it was an improvement over the previous methodology which assumed that coverage factors were identical for each class of mail. However, until volume data are available, the Commission believes the use of cost data is a reasonable proxy to calculate class—specific coverage factors. Once IMb utilization is sufficient, the Postal Service should file a petition to update the Flats Models.

In Modification Six, the Postal Service proposed to remove the costs of sorting mail to post office boxes from all three Flats Models and designate these costs as "non-modeled." This revision pertains to the CRA adjustment factor which contains a proportional component and a fixed per-piece component. The proportional component relates to the degree of worksharing and is sometimes referred to as workshare-related. The per-piece component reflects mail processing costs that do not vary with the degree of worksharing. Based on the record, the Commission approved Modification Six because the costs of sorting mail to post office boxes are properly treated as non-modeled or non-worksharing-related cost. The Commission found that the extent to which a piece is workshared does not appear to affect the cost of distributing it to a post office box.

Modifications Seven and Eight involve the cross-docking matrix[19] used to estimate container costs in the Periodicals model. In Modification Seven, the Postal Service proposed to update the method used to develop the cross-docking matrix. With Modification Eight, the Postal Service proposed to simplify the matrix and concurrent cost estimation.

In Modification Seven, the Postal Service proposed to use FY 2012 Q1 transportation route data instead of survey data to develop the cross-docking estimates. Where specific route information was not available, the Postal Service proposed to use labeling lists and parent facility assumptions. Further, the Postal Service smoothed the handlings to avoid anomalous results in sparsely populated matrix cells. The Commission approved Modification Seven because it relies on more current information and can be updated.

[19] A matrix used to calculate container costs by container type, presort level and entry point.

Modification Eight uses the results of Modification Seven to simplify the development of costs by type of container and entry facility for Periodicals. Modification eight proposed to use a simplified matrix of handling occurrences and handling costs to determine the total handling cost for containers. This simplified matrix identifies six types of container costs and determines the occurrence for each type of handling for each type of container. The Commission approved Modification Eight because it significantly reduced the complexity of the Periodicals Flats Model and did not materially impact the results of the container calculations.

The Commission accepted the eight modifications in Proposal Nine after the FY 2012 ACR was filed. Thus, the Postal Service's filings reflect the previous methodology and the proposed methodology. *See* Order 1656.

List of Commissions Directed Undertakings That May Result in Future Analytical Principle Changes

- *With Alaska Bypass Service replacing Single-Piece Parcel Post on the market dominant product list, the Postal Service must propose use of an appropriate proxy for Inbound Surface Parcel Post (at UPU rates) for service performance measurement in FY 2013. See Chapter VI at 61.*
- *Given the serious implications of the pricing of Standard Mail Flats, the Postal Service should derive elasticity estimates to provide for a more realistic assessment of the impact of price changes on contribution. See Chapter VII at 116.*
- *Regarding the negative passthrough for Standard automation mixed AADC letters, the Postal Service should reexamine the anomaly to better understand the costs associated with these workshare categories. See Chapter VII at 123.*
- *The Postal Service should provide an updated methodology for calculating the attributable costs of products handled by the Services Center in a rulemaking proceeding to change analytical principles prior to incorporating it into the FY 2013 ACR. The updated methodology should describe how the costs, revenues, and volumes are attributed to Stamp Fulfillment Services, Philatelic Services, and any other products handled at the Services Center. See Chapter VII at 143.*
- *With elimination of outbound International Reply Coupon Service, the Postal Service must report on the feasibility of providing separately reported costs for International Business Reply Mail Service in the FY 2013 ACR. See Chapter VII at 147.*
- *The Postal Service must file a methodology for estimating the attributable costs of Package Intercept Service in a rulemaking proceeding prior to incorporating the methodology in its FY 2013 ACR. See Chapter VIII at 163.*
- *The Postal Service must develop a costing methodology that adequately measures the attributable costs of the enhanced services for the competitive Post Office Box service. The Commission also directs the Postal Service to file the proposed methodology in a rulemaking proceeding prior to including the methodology in any future competitive rate adjustment for competitive Post Office Box service or in its FY 2013 ACR. See Chapter VIII at 163.*

- *The Postal Service must report on the feasibility of a special study designed to estimate the transaction volume and attributable costs of the IMTS-Inbound product within 90 days. The Postal Service is to report on estimating IMTS-Inbound transaction volumes based upon the POS system as presented in Proposal Eleven. The Postal Service shall also report on the feasibility of using revenues received from foreign postal operators as a basis for estimating IMTS-Inbound transaction volumes within 90 days. See Chapter VIII at 166.*
- *The Postal Service must modify its financial model for Global Plus and China Post Group NSAs to more accurately develop costs, or increase the contingency factor to accommodate costs that cannot be modeled, in order to ensure that negotiated prices can generate sufficient revenues to exceed attributable costs. See Chapter VIII at 164-172.*

Management Operating Data System (MODS)

The accuracy of cost estimates depends on the accuracy of MODS data. Errors in the MODS data translate into miscalculations of cost avoidances in the workshare models. Section 3652(a)(1) requires the Commission to prescribe the methods used to measure all quantities that the Postal Service reports to the Commission to support the Commission's determinations of compliance with the PAEA's standards. Applied to workshare discounts, the Commission's section 3652(a)(1) duty is to prescribe the methods of measuring the costs avoided by worksharing. [20]

In its FY 2012 ACR, the Postal Service noted an anomalous avoided cost relationship between Standard Mail machinable Mixed AADC presorted letters and automation Mixed AADC presorted letters. The FY 2012 cost avoidance is calculated at negative 0.3 cents. "Intuitively, this does not make sense – pre-barcoding a mailpiece should result in lower processing costs than not pre-barcoding the mailpiece, all else equal." United States Postal Service FY 2012 Annual Compliance Report at 21. It attributed this anomalous cost relationship to a large increase (112 percent) in the MODS ISS productivity as well to a large decrease (30 percent) in the MODS Outgoing BCS secondary productivity.[21]

Between FY 2010 and FY 2012, the "MODS Group 8 – Outgoing BCS Secondary" productivity[22] decreased from 10,103 pieces per hour to 6,119 pieces per hour.[23] No other MODS productivity value used in the letter cost avoidance models decreased to this extent, over the same time period.[24] The Commission reviewed the MODS daily-tour data file to gain further insight as to the possible causes of this apparent anomaly and its effect on workshare discounts.

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20 Order No. 536, Order Adopting Analytical Principles Regarding Workshare Discount Methodology, Docket No. RM2009-3, September 14, 2010 at 19.

21 The large increase in ISS productivities reduced the cost of applying a barcode to a Mixed ADC Nonautomation Machinable piece, and the large decrease in the Outgoing BCS secondary productivity increased the cost of sorting Automation Mixed AADC pieces. United States Postal Service FY 2012 Annual Compliance Report at 21.

22 Productivity is calculated as the Total Pieces Fed divided by the work hours logged in related grouped MODS operations. This mail processing ratio is a pieces-per-work hour measure used to calculate the avoided costs on which discounts are based.

23 Generally, depending on the particular MODS input, TPH mailflow and cost avoidance model, a large decrease in a MODS productivity input to the workshare models may increase the model/unit cost and a large increase in the MODS productivity input may decrease the model/unit cost. This numeric effect of a MODS productivity input on the unit costs in the workshare cost worksheets becomes apparent when the values listed in the "PRODUCTIVITY" worksheet change. The columns titled 'Pieces Per Hour' in the letter cost worksheets utilize the MODS productivity inputs from the 'PRODUCTIVITY' worksheet in arriving at the workshare model cost calculations. *See* USPS-FY12-10.

24 *See* USPS-FY10-23, YRscrub2010.xls, USPS-FY11-23, YRscrub2011.xls, and USPS-FY12-23, YRscrub2012.xls.

This review shows that work hour errors[25] appear to be rapidly increasing from year-to-year in a single MODS operation code (892- DBCS or DIOSS, Secondary Outgoing). Most of the data used in the calculation of the Outgoing BCS Secondary productivity ratio is captured in this operation code. Some work hour 'errors' logged in code 892 may be valid[26] if the related volume is recorded in an adjacent MODS tour.[27] Even if these observations are eliminated, a substantial number of daily-tour work hour errors remain in the aggregated MODS data used to calculate the productivity of letter sorting operations.

As shown in Table C-1, nearly 70,000 work hours in FY 2012 were logged to operation 892 without volumes recorded in the same tour or the adjacent tour. The Commission is concerned that these types of errors appear to be increasing. The Commission evaluated the type and magnitude of these work hour errors aggregated for the Outgoing BCS Secondary productivity calculation. It developed a programming algorithm[28] to search and eliminate work hour "errors" logged to an operation code on one tour at the facility, if the adjacent tour had any piece handlings recorded in that same operation.[29] This algorithm was developed because, according to the Postal Service, "tabulations of anomalous observations in tour-level data are not generally valid indicators of MODS data quality."[30] According to the Postal Service, "in high-frequency MODS data, anomalous observations may arise due to minor timing issues involving the volume and work hour measurement systems. In many such cases, the

Table C–1—MODS Operation Code 892–DBCS or DIOSS, Secondary Work Hour Status

Fiscal Year	Total Work Hours	Work Hours No Same Tour Volume Recorded	Percent of Total	Work Hour Errors No Same or Adjacent Tour Volume Recorded	Percent of Total
2010	386,180	69,278	17.9%	37,591	9.7%
2011	370,652	81,563	22.0%	47,599	12.8%
2012	370,216	116,157	31.4%	69,604	18.8%

Note: Possible valid work hour 'errors' (eliminated by the algorithm) is the difference between the no tour volume work hour columns.

Source: MODS FY 2010 (Docket No. N2012-1, LR-48), MODS FY 2011 (Docket No. N2012-1, LR-86) and MODS FY 2012 (USPS-FY12-NP31, Nonpublic Materials Provided in Response to Chairman's Information Request No.1, January 14, 2013).

25 This review focused on work hour observations that are erroneous because they are not associated with any piece handlings (no tour volume). Because the End-of-Run (webEOR) data automatically feeds the machine counts directly into the MODS system, the automated volumes in MODS are assumed to be correct. The other significant type of MODS error is piece handlings (volume) associated with zero work hours. This type of error in operation 892 was also assessed using the same logic algorithm and found little change between FY 2010 and FY 2012.

26 Postal Service Response to CHIR No. 4, question 21.

27 It appears the Postal Service, is referring to "timing issues" when the piece handling data fed by the WebEOR system and work hours data fed by the TACS system may appear in the MODS system as having been incurred on adjacent MODS tours on the same MODS day and in adjacent tours on the previous MODS day or next MODS day. Also, in the past, the Postal Service explained that: "Some workhours for an operation may be recorded in a tour adjacent to the tour in which the associated workload is recorded." *See* Docket No. N2012-1, Institutional Response of the United States Postal Service to Public Representative Interrogatory PR/USPS-4, April 19, 2012.

28 Using SAS 9.3, the programming algorithm searched possible/logical adjacent tours using the MODS day tour shift order, MODS date, previous MODS date/adjacent tour and next MODS date/adjacent tour to identify and eliminate possible 'good' hours logged in a tour that had some volume recorded (in the same operation code) in the adjacent tour.

29 The reasonableness of the values in the adjacent tours was not assessed.

30 Postal Service Response to CHIR No. 4, question 21.

anomalous data will be valid."[31] The Commission found that for a portion of the work hours logged to operation 892 (without volume recorded in the same tour), this may be the case because the adjacent tour did have volume recorded. However, a larger portion of work hours logged to operation 892 without accompanying volume does not appear to be valid (approximately 19 percent of all operation 892 work hours in FY 2012 had no same tour volume or adjacent tour volume recorded in MODS). When errors increase in the MODS data used for pricing and costing, it undermines confidence in the validity of those model results.

It is unclear from the Postal Service's response to CHIR No. 4, question 23, to what extent erroneous work hour observations logged in operation 892 occur because field personnel erroneously believe that operation 891 (DBCS or DIOSS, Primary Outgoing) and operation 892 (DBCS or DIOSS, Secondary Outgoing) are combined for pricing and costing purposes (so that work hours erroneously clocked into one or the other operation would be correct when aggregated).[32] However, MODS operations 891 and 892 are not combined in the same MODS productivity group and map to two different MODS productivity inputs used in the letter workshare models.[33]

Based on the Commission's review of the MODS data file, it is apparent that the facilities recording many of the erroneous work hour observations in operation 892 also record MODS mail processing data in operation 891 on the same tour and date. This raises questions as to whether these facilities are significant sources of erroneously low Outgoing BCS Secondary productivity values arising from a lack of piece handlings associated with positive work hours in operation 892. The Postal Service notes that to some extent, work hours logged to operation 892 (without accompanying volume) are offset by MODS data where hours are understated.[34] It is not clear to the Commission to what extent, or how, the work hours are offset.

A recent USPS Office of Inspector General (OIG) MODS audit report[35] found that the MODS data examined did not support all of the assumptions Postal Service finance personnel used in aggregating facility observations at the productivity group level. The OIG recommended that the Postal Service focus its corrective actions on those mail processing facilities creating the most significant number of MODS errors.[36] For the work hour errors logged in Operation 892, the FY 2012 MODS daily-tour data file shows a large number of work hour errors being recorded by a small subset of facilities. The Commission agrees with the OIG that the Postal Service should focus on that subset in developing plans to improve the accuracy of MODS data.

To prevent anomalous cost relationships in the future, the Postal Service plans to study the effect of de-averaging the productivity data for Multi-mode and the Barcode Sorting (BCS) modes of the letter automation machines

[31] *Id.*

[32] *See* the Productivity Group and Cost Pool discussion in: United States Postal Service Office of Inspector General, Management Operating Data System Audit Report, Report Number CRR-AR-12-002, December 13, 2011 at 6.

[33] Postal Service Response to CHIR No. 4, question 16, ChIR4.Q16.xls, 'USPS-FY12-23 MODS Code to MODS Operation Group Map.' Operation 891 maps to the 'Outgoing BCS Primary' productivity group and operation 892 maps to the 'Outgoing BCS Secondary' productivity group.

[34] Responses of The United States Postal Service to Questions 5-7 of Chairman's Information Request No. 9, March 8, 2013, (Postal Service Response to CHIR No. 9), question 5.

[35] United States Postal Service Office of Inspector General, Management Operating Data System Audit Report, Report Number CRR-AR-12-002, December 13, 2011 at 7.

[36] *Id.* at 2.

and review the relationships of downflow operations to evaluate whether enhancements can be made.[37] The Postal Service asserts that: "While errors in workhours need not lead to biases in productivities per se, particularly when the errors can be aggregated (or, equivalently, averaged) over large numbers of observations, the Postal Service recognizes that some forms of misclocking may lead to bias (not necessarily downward bias) in measured productivities."[38] From the quantity of work hour errors in operation 892, the Postal Service should demonstrate how aggregating work hour errors in operation 892 does not lead to bias.

In general, identifying and eliminating the sources of non-sample error in the MODS data will result in more accurate cost avoidance estimates. More accurate MODS data would also provide a more reliable guide to the Postal Service as it plans the reconfiguration of its mail processing network and evaluates its effects. Providing the MODS data and changes in the MODS operational definitions annually will increase transparency related to Postal Service procedures and assumptions for data directly used in costing and pricing. In the next ACR filing, the Commission would like a report on what alternative methods for calculating productivity measures the Postal Service has considered. It also directs the Postal Service to provide a more thorough assessment of the effect of non-sample error on the Outgoing BCS Secondary and Primary productivities as well as efforts taken to reduce non-sample error in the MODS. Validity of the Outgoing BCS Secondary productivity estimate in light of the increasing aggregated daily-tour work hour errors in operation 892 should be demonstrated by the Postal Service in its next ACR filing.

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37 Responses of The United States Postal Service to Questions 1-2 and 4-24 of Chairman's Information Request No. 4, January 25, 2013 (Postal Service Response to CHIR No. 4), question 6.

38 Postal Service Response to CHIR No. 9, question 5.

Appendix D

Financial Results Under Current Classification

This appendix presents Postal Service financial results for FY 2012 using the mail classification system in place since the passage of the PAEA. Prior to the PAEA, mail classes were subdivided into subclasses, and the financial reports reflected that organization. The PAEA uses the term product, defined as "a postal service with a distinct costs or market characteristic for which a rate or rates are, or may reasonably be applied." 39 U.S.C. 102(6). Within classes, the Postal Service reports data by product, not by subclass. To facilitate historical comparisons, Table D-1 presents volumes, revenues, attributable costs, and contribution to institutional cost using the current classification scheme.

Table D–1—Fiscal Year 2012 Volume, Revenue, Cost and Cost Coverage by Class Current Classification (Products)

	Volume (000)	Revenue ($000)	Attributable Cost ($000)	Contribution to Institutional Cost ($000)	Rev./Pc. (Cents)	Cost/Pc. (Cents)	Contribution to Institutional Cost/Pc. (Cents)	Cost Coverage
Competitive Mail								
Express Mail	39,823	801,561	467,227	334,334	2,012.806	1,173.256	839.550	171.6%
Priority Mail	824,202	5,939,726	4,545,341	1,394,385	720.664	551.484	169.180	130.7%
Parcel Select and Parcel Return Service (PRS)	984,202	1,456,216	1,105,767	350,450	147.959	112.352	35.608	131.7%
First-Class Package Service	411,424	875,654	766,719	108,935	212.835	186.357	26.478	114.2%
Competitive International Mail	273,525	1,837,317	1,216,598	620,719	671.717	444.784	226.933	151.0%
Competitive Domestic Services		504,824	273,118	231,706				184.8%
Competitive International Services		10,577	8,391	2,187				126.1%
Total Competitive Mail and Services	**2,533,176.161**	**11,425,875**	**8,383,159**	**3,042,716**	**451.049**	**330.935**	**120.115**	**136.3%**
Market Dominant Mail								
First-Class Mail								
Single-Piece Letters and Cards	23,913,510.21	10,963,807	6,573,112	4,390,695	45.848	27.487	18.361	166.8%
Presort Letters and Cards	42,733,615.90	15,229,079	5,191,600	10,037,479	35.637	12.149	23.488	293.3%
Flats	2,049,176.33	2,673,160	1,791,045	882,115	130.450	87.403	43.047	149.3%
Parcels	293,412.83	649,499	659,147	(9,648)	221.360	224.648	(3.288)	98.5%
Outbound Single-Piece Mail Intl	263,547.71	665,500	438,548	226,952	252.516	166.402	86.114	151.8%
Inbound Single-Piece Mail Intl	386,306.51	252,423	345,217	(92,794)				73.1%
Standard Mail								
High Density & Saturation Letters	5,563,559	770,882	346,973	423,908	13.856	6.237	7.619	222.2%
High Density & Saturation Flats & Parcels	11,770,275	1,955,823	900,140	1,055,683	16.617	7.648	8.969	217.3%
Carrier Route	9,119,946	2,249,836	1,720,605	529,231	24.669	18.866	5.803	130.8%
Letters	47,102,691	9,213,404	5,149,404	4,064,000	19.560	10.932	8.628	178.9%
Flats	5,939,635	2,233,730	2,761,670	(527,940)	37.607	46.496	(8.888)	80.9%
Not Flat-Machinables and Parcels	303,559	288,894	337,853	(48,959)	95.169	111.297	(16.128)	85.5%
Inbound NSA Mail Intl	1,345	702	148	554				
Periodicals								
Within County	631,286	67,269	95,398	(28,129)	10.656	15.112	(4.456)	70.5%
Outside County	6,110,064	1,664,217	2,306,204	(641,987)	27.237	37.744	(10.507)	72.2%
Package Services								
Single-Piece Parcel Post	70,971	774,438	840,359	(65,921)	1,091.206	1,184.092	(92.885)	92.2%
Inbound Surface Parcel Post (at UPU Rates)	1,115	20,908	11,594	9,314	1,875.297	1,039.879	835.419	180.3%
Bound Printed Matter Flats	230,522	186,887	138,302	48,585	81.071	59.995	21.076	135.1%
Bound Printed Matter Parcels	243,308	306,651	281,152	25,498	126.034	115.554	10.480	109.1%
Media and Library Mail	100,422	321,246	376,770	(55,524)	319.896	375.187	(55.291)	85.3%
Inbound NSA Mail Intl	8	18	3	15				
U.S. Postal Service Mail	440,452							
Free Mail	56,952		39,586	(39,586)		69.507		
Total Market Dominant Mail	**157,325,678**	**50,488,371**	**30,304,829.905**	**20,183,541**	**32.092**	**19.262**	**12.829**	**166.6%**

Table D–1—Fiscal Year 2012 Volume, Revenue, Cost and Cost Coverage by Class Current Classification—Continued

	Volume (000)	Revenue ($000)	Attributable Cost ($000)	Contribution to Institutional Cost ($000)	Rev./Pc. (Cents)	Cost/ Pc. (Cents)	Contribution to Institutional Cost/Pc. (Cents)	Cost Coverage
Market Dominant Services								
Ancillary Services								
Certified Mail		662,806	601,869	60,937				110.1%
COD		5,927	3,604	2,323				164.5%
Insurance		108,510	96,969	11,541				111.9%
Registered Mail		39,477	30,226	9,251				130.6%
Stamped Envelopes		16,584	6,389	10,196				259.6%
Stamped Cards		2,117	731	1,386				289.6%
Other Ancillary Services		696,601	547,852	148,749				127.2%
Money Orders		165,093	110,474	54,619				149.4%
Post Office Box Service		481,567	377,073	104,493				127.7%
Caller Service		92,490	27,045	65,445				
Other Special Services		33,988	15,084	18,903				
International Services		**29,435**	**22,763**	**6,672**				**129.3%**
Other Income		927,529		927,529				
Total Mail and Services	**159,858,854**	**65,176,370**	**40,528,068**	**24,648,302**	**40.771**	**25.352**	**15.419**	**160.8%**
Institutional Costs			40,625,129					
Appropriations: Revenue Forgone		46,204						
Investment Income		24,657						
Total Revenues		**65,247,231**						
Total Costs			**81,153,198**					
Net Income (Loss)		**(15,905,966)**						

Source: Library Reference PRC-ACR2012-LR1

Appendix E

Abbreviations and Acronyms

Long Version	Abbreviation/Acronym
Address Management Services	AMS
Alliance of Nonprofit Mailers	ANM
American Business Media	ABM
American Catalog Mailer Association	ACMA
Annual Compliance Determination	ACD
Annual Compliance Report	ACR
FY 2012 Annual Performance Plan	FY 2012 Plan
FY 2013 Annual Performance Plan	FY 2013 Plan
FY 2011 Annual Performance Report	FY 2011 Report
FY 2012 Annual Performance Report	FY 2012 Report
Area Distribution Center	ADC
Automated Area Distribution Center	AADC
Automated Postal Center	APC
Bound Printed Matter	BPM
Bulk Metered Mail	BMM
Chairman's Information Request	CHIR
Collect on Delivery	COD
Collection Point Management System	CPMS
2010 Comprehensive Statement on Postal Operations	FY 2010 Comprehensive Statement
Consumer Price Index	CPI
Consumer Price Index for all urban consumers	CPI-U
Community Post Offices	CPOs
Cost and Revenue Analysis	CRA
Critical Entry Times	CET
Customer Experience Measurement	CEM
Customer Supplier Agreements	CSAs
Deliveries per Work Hour	DPWH
Delivery Bar Code Sorter	DBCS
Delivery Point Sequence	DPS
Destination Sectional Center Facilities	DSCF
Destination Area Distribution Center	DADC
Destination Delivery Unit	DDU
Destination Bulk Mail Center	DBMC
Destination Network Delivery Center	DNDC

Long Version	Abbreviation/Acronym
Direct Marketing Association, Inc.	DMA
Educational, cultural, scientific or informational [value]	ECSI
Every Door Direct Mail	EDDM
Express Mail Service	EMS
External First-Class Measurement System	EXFC
Federal Employee Retirement System	FERS
First-Class Mail International	FCMI
Flats Sequencing System	FSS
Foreign Post Settlement	FPS
Global Bulk Economy	GBE
Global Direct	GD
Global Expedited Package Services	GEPS
Global Expedited Package Service Non-published Rates 2	GEPS—NPR 2
Global Reseller Expedited Package Services 1	GREPS 1
Gross Domestic Product	GDP
Integrated Financial Plan	IFP
Intelligent Mail Barcode	IMb
Intelligent Mail Accuracy and Performance System	iMAPS
International Cost and Revenue Analysis	ICRA
International Mail Measurement System	IMMS
International Money Transfer Service – Outbound	IMTS-Outbound
International Priority Airmail	IPA
International Service Center	ISC
International Surface Airlift	ISAL
In-Office Cost System	IOCS
Mailer Identification	MID
Mixed Area Distribution Center	MADC
National Association of Presort Mailers	NAPM
National Postal Policy Council	NPPC
Negotiated Service Agreement	NSA
Network Distribution Center	NDC
Not-Flat Machinables	NFMs
Office of Personnel Management	OPM
Officially Licensed Retail Products	OLRP
Occupational Safety and Health Administration	OSHA
Origin Area Distribution Center	OADC
Origin Bulk Mail Center	OBMC
Origin Network Distribution Center	ONDC
Origin Sectional Center Facility	OSCF
Parcel Shippers Association	PSA
Point of Service	POS
Post Office Box	PO Box
Postal Accountability and Enhancement Act	PAEA
Postal Qualified Wholesalers	PQW

Long Version	Abbreviation/Acronym
Product Tracking System	PTS
Qualified Business Reply Mail	QBRM
Quality Link Measurement System	QLMS
Postal Service Retirement Health Benefits Fund	RHBF
Retail Access Optimization Initiative	RAOI
Revenue, Pieces, and Weights	RPW
Sectional Center Facility	SCF
Securities and Exchange Commission	SEC
Stamp Fulfillment Services	SFS
Total Factor Productivity	TFP
Universal Postal Union	UPU
Village Post Offices	VPO
Voice of the Employee	VOE

Appendix F

Commenters–2012 Annual Compliance Determination

Commenter	Comment Citation	Citation Short Form
American Catalog Mailers Association	Initial Comments of the American Catalog Mailers Association (ACMA) February 1, 2013	ACMA Comments
American Catalog Mailers Association	Reply Comments of the American Catalog Mailers Association (ACMA) February 15, 2013	ACMA Reply Comments
American Catalog Mailers Association	Surreply Comments of the American Catalog Mailers Association (ACMA) February 20, 2013	ACMA Reply Comments
Alliance of Nonprofit Mailers	Comments of Alliance of Nonprofit Mailers February 1, 2013	ANM Comments
Alliance of Nonprofit Mailers	Comments of Alliance of Nonprofit Mailers February 4, 2013	ANM Comments
Alliance of Nonprofit Mailers	Errata Notice of Alliance of Nonprofit Mailers February 4, 2013	ANM Errata Notice
Direct Marketing Association	Comments of the Direct Marketing Association, Responding to Commission Order No. 1609 February 1, 2013	DMA Comments
Greeting Card Association	Comments of the Greeting Card Association February 1, 2013	GCA Comments
Comments of Mark Jamison	Follow-up Comments to Chairman's Information Request 5, questions 34 and 35 February 7, 2013	Comments of Mark Jamison
Magazine Publishers of America, Inc., and Alliance of Nonprofit Mailers	Reply Comments of Magazine Publishers of America, Inc., and Alliance of Nonprofit Mailers February 15, 2013	MPA et al. Reply Comments
National Postal Policy Council	Comments of the National Postal Policy Council February 1, 2013	NPPC Comments
Pitney Bowes, Inc	Comments of Pitney Bowes Inc. February 1, 2013	PB Comments
Public Representative	Public Representative Comments February 1, 2013	PR Comments

Commenter	Comment Citation	Citation Short Form
Public Representative	Public Representative Reply Comments	PR Reply Comments
	February 19, 2013	
Public Representative	Public Representative Motion for Leave to File Reply Comments One Business Day Late	PR Reply Comments
	February 19, 2013	
Public Representative	Public Representative Response to Surreply Comments of the American Catalog Mailers Association	PR Surreply Comments
	February 27, 2013	
Public Representative	Public Representative Notice of Errata to Public Representative Response to Surreply Comments of the American Catalog Mailers Association	PR Notice of Errata to Surreply Comments
	February 28, 2013	
Time Inc.	Reply Comments of Time Inc. on USPS FY 2012 Annual Compliance Report	Time Reply Comments
	February 15, 2013	
Time Inc.	Erratum to Reply Comments of Time Inc. on USPS FY 2012 Annual Compliance Report	Time Erratum Reply Comments
	February 15, 2013	
United States Postal Service	Reply Comments of the United States Postal Service	Postal Service Reply Comments
	February 15, 2013	
Valpak Direct Marketing Systems, Inc. and Valpak Dealers' Association, Inc.	Valpak Direct Marketing Systems, Inc. and Valpak Dealers' Association, Inc. Initial Comments on the United States Postal Service FY 2012 Annual Compliance Report	Valpak Initial Comments
	February 1, 2013	
Valpak Direct Marketing Systems, Inc. and Valpak Dealers' Association, Inc.	Valpak Direct Marketing Systems, Inc. and Valpak Dealers' Association, Inc. Reply Comments on the United States Postal Service FY 2012 Annual Compliance Report	Valpak Reply Comments
	February 15, 2013	

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