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ANNUAL COMPLIANCE DETERMINATION REPORT

FISCAL YEAR 2013

U.S. POSTAL REGULATORY COMMISSION

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MESSAGE FROM THE CHAIRMAN

On behalf of the Postal Regulatory Commission, I am pleased to present this Annual Compliance Determination (ACD) reviewing the U.S. Postal Service's compliance with pricing and service performance standards for Fiscal Year 2013. The Commission is issuing two additional reports this year: a separate Financial Report and a report analyzing the Postal Service's performance plans and program performance.

In part due to regulatory oversight, the Postal Service has shown improvement in important areas. The Commission approved the use of Intelligent Mail barcodes (IMb) for service measurement in 2008 and has been urging robust implementation of IMb during the last six years. It is encouraging to see that service performance has improved for many categories as the Postal Service has moved more aggressively to implement broader use of IMb, and with it the ability to track mail and correct problems. Competitive products are providing higher overall cost coverage than in FY 2012. Competitive products are also making a larger contribution than in FY 2012, more than the Commission-mandated minimum. The Commission welcomes and consistently has approved innovations submitted by the Postal Service including new negotiated service agreements and market tests of experimental products. Furthermore, both the Periodicals Class and the Standard Flats product have reduced their deficits and narrowed their cost coverage shortfalls.

However, this ACD also points out three major recurring compliance challenges that the Postal Service should address in the coming year.

First, this year a sizable number of the Postal Service's workshare discounts were not in compliance with the current law, exceeding the avoided cost savings from worksharing, often without a statutory exception. The Postal Service's financial position is harmed by losses due to discounts that exceed the costs avoided by the Postal Service when mailers prepare, sort and transport their mail. Ensuring that worksharing discounts comply with the law is an important part of the Commission's statutory responsibilities. The ACD identifies at least two ways in which the Postal Service could address this recurring compliance issue. The Commission is committed to supporting Postal Service efforts to resolve this situation.

Losses in Standard Flats are a second recurring concern. Our ACD commends the Postal Service's progress toward reducing its cost coverage shortfall as it continues with annual incremental above-CPI price increases for Standard Flats, as directed by the Commission's FY 2010 ACD. However, to close the gap for Standard Flats, the Postal Service will be aided, as noted in the FY 2010 ACD, by "efforts to streamline operations, to capture efficiency and reduce costs." The Commission discusses in this ACD that the Postal Service cost savings programs for Flats processing "should have specific, measurable targets by which the benefits of the program can be evaluated."

Third, the Postal Service faces a daunting challenge in achieving full cost coverage for the Periodicals Class. The continuation of inefficient pricing signals, including the various charges to mailers for preparation options such as pallets and bundles, add to its shortfall. Inefficient pricing signals discourage mail preparation which would reduce Postal Service costs. The Commission once again calls on the Postal Service to use its pricing flexibility within the price cap to mitigate the revenue shortfall for Periodicals.

The Commission is charged with assuring that the Postal Service maintains adequate levels of service. Maintaining service performance, customer access, and customer satisfaction are important for any service provider or business, but are of paramount importance for a monopoly and a government entity required to provide an essential communications network for the Nation. Overall, the Postal Service is measuring delivery performance for an increasing fraction of mail, and this provides increased visibility and service quality assessment.

However, two specific areas still require improvement. One is resolving the large number of post office retail facilities that remain under emergency suspension for prolonged periods of time. The other is satisfactory and prompt resolution of customer complaints. Customers gain confidence in the Postal Service when they know their concerns are being addressed, and are more likely to continue to use the mail.

I wish to thank my colleagues, Vice Chairman Mark Acton and Commissioner Robert Taub, for their valuable work and contributions to this report. Along with my fellow Commissioners, I want to recognize the Commission staff's outstanding efforts and dedication to our work.

Ruth Y. Goldway

Ruth Y. Goldway
Chairman

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EXECUTIVE SUMMARY

This report reviews the Postal Service's performance in Fiscal Year 2013, 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 (in italics) in each chapter.

The Commission has adopted a different approach for its ACD this year. This ACD focuses on compliance issues as defined in 39 U.S.C. 3653(b)(1) and (b)(2). These statutory subsections require the Commission to make determinations on whether any rates and fees in effect during FY 2013 were not in compliance with chapter 36 of title 39 U.S. Code and whether any service standards in effect during FY 2013 were not met. The financial analysis that had been incorporated in past ACDs has been expanded and issued as a separate report. The Commission will issue a separate report on the Postal Service's Performance Plans and Program Performance to fulfill its statutory responsibilities under 39 U.S.C. 3653(c).

PRINCIPAL FINDINGS

Market Dominant Rate and Fee Compliance

The Commission identified 42 compliance issues related to workshare discounts, finding that 18 of the 42 workshare discounts did not comply with section 3622(e), which directs the Commission to ensure that workshare discounts do not exceed the costs avoided by the Postal Service as a result of the worksharing activity. *See* Chapter 2.

- For 15 of those 18 workshare discounts not in compliance with section 3622(e), the Postal Service did not propose a statutory exception but rather cites a lag between estimation of current cost avoidances and pre-existing discounts. Without persuasive statutory exceptions, the Commission must find these discounts out of compliance with section 3622(e).

- Because the timing of pricing adjustments is not a statutory exemption for passthroughs over 100 percent, for these 15 discounts the Commission recommends that the Postal Service consider different approaches for setting workshare discounts, including projecting cost avoidances, that may reduce the number of discounts with passthroughs above 100 percent resulting from the timing of price adjustments. Alternatively, the Postal Service should consider revising the schedule of market dominant price adjustments.

- For the remaining three workshare discounts that did not comply with section 3622(e), the Commission does not find the Postal Service's proposed statutory exceptions to be persuasive. As a result, the Commission concludes that they do not apply, and thus these discounts are out of compliance with section 3622(e).

- Of the 18 workshare discounts that did not comply with section 3622(e), four were aligned with avoided costs in Docket No. R2013-11, and 14 must be aligned with avoided costs in the next market dominant price adjustment, or else the Postal Service must specify an applicable statutory exception.

Competitive Products Rate and Fee Compliance

Revenues for the following four products did not cover attributable costs and thus did not comply with section 3633(a)(2): Parcel Return Service Contract 4, International Priority Airmail (IPA), International Air Parcel Post (at non-Universal Postal Union (UPU) rates), and International Money Transfer Service – Outbound. The Commission orders the Postal Service to take corrective action. *See* Chapter 4.

Market Dominant Products Service Performance

The Postal Service met its service performance targets for Presorted First-Class Letters/Postcards. In FY 2013, a majority of market dominant mail products did not meet annual service performance targets. Similar to FY 2012, most products made significant improvements over the course of the fiscal year.

An increase in the number of pieces with Full-Service Intelligent Mail barcodes resulted in more robust product-level measurement. Products within Package Services continue to present measurement challenges for the Postal Service.

During FY 2013, the Postal Service implemented new service standards for several classes of mail. A major impact resulting from these changes was a decrease in volumes of First-Class Mail Presorted Letters/Postcards with overnight and 2-day service standards and an increase in the volume of pieces with a 3-5-day service standard. As a result, for mail affected by the changes, it is difficult to compare FY 2013 service performance results with past years.

Noncompensatory Products

In FY 2013, nine market dominant products were noncompensatory. These products were First-Class Parcels, Periodicals Within County and Outside County, Standard Flats, Standard Parcels, Single-Piece Parcel Post, Media/Library Mail, Inbound Letterpost and Stamp Fulfillment Services.
Concerning Standard Mail Flats, the Commission finds that progress is being made toward addressing the issues raised by the Commission in the FY 2010 ACD. As a result, no further remedial action is required at this time. *See* Chapter 3.

For Periodicals, in the FY 2014 ACR, the Postal Service must provide a detailed analysis of the progress made in improving Periodicals cost coverage. This report shall include:

- The impact of leveraging its pricing flexibility to improve the efficiency of Periodicals pricing;
- The impact of the implementation of operational strategies outlined in Chapter 7 of the Periodicals Mail Study; and
- The progress in implementing pricing strategies outlined in Chapter 7 of the Periodicals Mail Study.

For Inbound Letterpost the Commission recommends that the Postal Service continue to negotiate more compensatory bilateral (or multilateral) agreements with foreign postal operators in the upcoming fiscal year.

For the other noncompensatory products, the Commission finds that the Postal Service is taking appropriate steps to improve cost coverage.

Customer Access and Satisfaction

The Commission makes several principal findings regarding customer access and customer satisfaction.

- Some of the offices under emergency suspension have been under study for possible discontinuance for over two years. The Postal Service should proceed expeditiously in either discontinuing offices under suspension or reopening them.
- The number of collection points decreased by three percent from FY 2012 to FY 2013.
- The average wait time in line was less than five minutes and improved over last year in almost all districts.
- Regarding the Customer Experience Measurement survey, the Commission found that customers were generally satisfied with their overall experience when visiting post offices, but were less satisfied with resolution of complaints.

CHAPTER 1

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). The second provision, 39 U.S.C. 3653, requires the Commission to review the Postal Service's annual reports and issue an ACD regarding whether rates were not in compliance with applicable provisions of the title and whether any service standards were not met. 39 U.S.C. 3653(b). Together, these provisions establish the ACR and the ACD as integrated mechanisms for providing ongoing accountability, transparency, and oversight of the Postal Service.

In prior years, the ACD reported on the Postal Service's financial condition and its performance plans and program performance. Beginning this year, the Commission will report on those issues separately.[2] This ACD focuses on the requirements of sections 3653(b)(1) and (b)(2).[3] The analysis of the Postal Service's finances was issued in a separate report on March 18, 2014.[4] The analysis of the Postal Service's performance plans and program performance, required by 39 U.S.C. 3653(d), will also be issued in a separate report in May of 2014.

For regulations governing rates and fees in the PAEA, Congress divided mail categories and services between market dominant and competitive products. For market dominant products, the relevant sections of title 39 for rates and fees are sections 3622 and 3626. For competitive products, the relevant section is 3633.

The analysis of rates and fees that have been challenged as not in compliance is contained in three chapters. In Chapter 2, the Commission evaluates the workshare discounts for market dominant products to determine compliance with 39 U.S.C. 3622(e). The introduction to Chapter 2 also includes a discussion about the preferred rate requirements and the price cap. Chapter 3 focuses on other

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

[2] *See* Docket No. ACR2013, Order No.1972, Notice Regarding the Postal Service's FY 2013 Performance Report and FY 2014 Performance Plan, January 17, 2014.

[3] In this ACD, the Commission only addresses rates and fees that have been challenged as not in compliance.

[4] PRC-FinRpt13-NP-LR1 - PRC Financial Analysis, 2013: FY 2013 Postal Service's Product Finances, March 18, 2014.

compliance issues related to rates and fees of market dominant products. Chapter 4 covers compliance issues related to the rates and fees of competitive products. In Chapter 5, the Commission discusses service performance and measurement.

There are five appendices to the ACD. Appendix A contains an empirical review of the price cap application. Appendix B provides an evaluation of the Postal Service's special study of delivery performance in remote locations. Appendix C provides the status of Commission directed undertakings from past ACDs and new Commission directed undertakings in this ACD. Appendix D contains a list of Commenters. Appendix E contains an index of abbreviations used in this ACD.

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, 2013). The Commission is required to complete the ACD within 90 days after receiving the ACR. The Postal Service filed the FY 2013 ACR on December 27, 2013. Thus, the Commission must issue this ACD no later than March 27, 2014.

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 Postal Service must include product information, mail volumes, and measures of quality of service, including the speed of delivery, reliability, and the levels of customer satisfaction. For market dominant products with workshare discounts, the Postal Service 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(b).

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

Upon receipt of the ACR, the Commission provides an opportunity for public comment on the Postal Service's submissions. 39 U.S.C. 3653(a). The Commission is responsible for 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(b). If a determination of non-compliance is made, the Commission is required to take such action as it deems appropriate. 39 U.S.C. 3653(c).

PROCEDURAL HISTORY

On December 27, 2013, the Postal Service filed its FY 2013 ACR, covering the period from October 1, 2012, through September 30, 2013. 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-FY13-9 summarizes the other materials included in the ACR submission and contains a list of special studies and a discussion of obsolescence[5] in response to 39 CFR 3050.12.

The Postal Service concurrently filed its 2013 Comprehensive Statement on Postal Operations, which included the Postal Service's 2013 Annual Performance Report and 2014 Performance Plan.[6] 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-FY13-39.

On December 30, 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. ACR2013 as a formal docket to consider the ACR, and appointing a Public Representative to represent the interests of the general public.[7] It established January 31, 2014, as the deadline for comments and February 14, 2014, as the deadline for reply comments.

METHODOLOGY CHANGES

The Postal Service reports that the FY 2013 ACR generally employs the methodologies applied in the FY 2012 ACR. The Postal Service identifies two approved and nine pending changes to methodologies. The approved changes are incorporated into the FY 2013 ACR. The Postal Service indicates that of the nine pending changes to methodologies, it used three changes in instances where it was not practical to file the FY 2013 ACR without using the pending changes. The Postal Service requests that the Commission provide each model used in the preparation of the FY 2013 ACD at the time the FY 2013 ACD is issued, in order to ensure that the most up-to-date models are used in the future ACRs. FY 2013 ACR at 7-8. The Commission routinely posts the most current workshare cost avoidance models on its website.[8] Those models were used in its preparation of the FY 2013 ACD.

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

[6] 2013 Comprehensive Statement of Postal Operations, December 27, 2013. These documents were filed as part of Library Reference USPS-FY13-17.

[7] *See* Docket No. ACR2013, Notice of Postal Service's Filing of Annual Compliance Report and Request for Public Comments, December 30, 2013 (Order No. 1935); *see also* 79 FR 669-671 (January 6, 2014).

[8] *See* Directory of PRC Workshare Cost Avoidance Models at http://www.prc.gov/PRC-DOCS/UploadedDocuments/Directory%20of%20PRC%20Workshare%20Cost%20Avoidance%20Models%207%2029%202013_3233.pdf.

PRODUCT ANALYSIS

The Postal Service provides an analysis of each market dominant product, including special services, and domestic and international negotiated service agreements entered into during FY 2013. 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 CFR 3015.7. Finally, the Postal Service discusses the two market dominant market tests and two competitive market tests conducted in FY 2013, as well as two market dominant and nine competitive nonpostal products.

SERVICE PERFORMANCE

The FY 2013 ACR also includes information regarding service performance, customer satisfaction, and consumer access, as required under 39 U.S.C. 3652(a)(2) and 39 CFR Part 3055.

CONFIDENTIALITY

Commission rules require the Postal Service, when it files non-public materials with the Commission, to simultaneously file an application for non-public treatment. 39 CFR 3007.20. The application for non-public treatment must clearly identify all non-public materials and fulfill the burden of persuasion that the non-public materials should be withheld from the public by showing that the particular information is commercially sensitive and by identifying the nature, extent, and likelihood of commercial harm that would result from disclosure. The ACR includes such an application with respect to certain competitive products.

REQUESTS FOR ADDITIONAL INFORMATION

Sixteen Chairman's Information Requests (CHIRs) were issued with respect to the ACR during the period beginning January 3, 2014, and ending March 21, 2014. The Postal Service responded to the 16 CHIRs, often filing supplemental information in support of the responses. The Commission appreciates the Postal Service's responsiveness to the CHIRs.

CHAPTER 2

MARKET DOMINANT PRODUCTS: PRICING REQUIREMENTS

INTRODUCTION

The PAEA introduced three pricing requirements for market dominant products: (1) a class-level price cap; (2) a cap on workshare discounts; and (3) a cap on preferred rates. The Commission approved the price increases for the prices in effect during FY 2013, thus the prices complied with the price cap provision. However, because changes in prices generally affect the mix of volumes within classes, after rate price increases by class may differ from the price increase based on historical billing determinants. In Appendix A, the Commission analyzes the after-rate price change. This chapter provides an analysis of workshare discounts and preferred rates.

Workshare discounts provide reduced rates for mail prepared or entered so as to avoid certain activities the Postal Service would otherwise have to perform. These discounts are based on the estimated costs avoided as a result of the mailer performing the activity. 39 U.S.C. 3622(e)(2) directs the Commission to ensure that workshare discounts do not exceed the costs avoided by the Postal Service as a result of the worksharing activity. The statute provides four exceptions to this requirement. *See* 39 U.S.C. 3622(e)(2)(A) through (D).

The Commission analyzes the discounts to determine whether they comply with applicable statutory provisions. Workshare discounts that are not greater than their avoided costs are in compliance for FY 2013 and require no further discussion.[1]

This chapter discusses workshare discounts, organized by class of mail, that are greater than their avoided costs. Two issues that affect workshare discounts are addressed first: (1) a timing issue that adversely affects workshare discounts' compliance with 39 U.S.C. 3622(e)(2); and (2) the methodology for calculating the avoided costs for the Automated Area Distribution Center (AADC) categories in First-Class Mail and Standard Mail.

Timing of Price Adjustments

Since October 18, 2011, when the Postal Service altered its schedule of planned price changes and informed the mailing community that it planned to adjust market dominant prices in January of each year, there has been an increase in the number of discounts that passthrough more than 100 percent of avoided cost at the time of the Postal Service's ACR.

[1] The difference between the workshare discount and the avoided cost is referred to as the "passthrough." Passthroughs above 100 percent indicate discounts that are greater than avoided costs. Passthroughs below 100 percent indicate discounts that are below avoided costs.

The Postal Service is required by statute to give notice of price adjustments. In general, the Postal Service provides notice of price adjustments for the upcoming year in October. Although the Postal Service's fiscal year ends in September, cost data for that fiscal year is not available until December when the Postal Service files its ACR. Consequently, the cost data the Postal Service relies on for setting workshare discounts in October are nearly two years old. As part of its compliance determination, the Commission compares the discounts in effect during a fiscal year with the cost avoidances for that fiscal year. The two-year lag between the data that are used to set discounts and the data used to evaluate discounts increases the number of discounts that pass through more than avoided costs. The timing issue applicable to the current ACD is discussed below.

On October 11, 2012, the Postal Service filed a notice of market dominant price adjustments. The Postal Service developed workshare discounts in that price adjustment using the most recent fiscal year data at the time, FY 2011 data. In the FY 2013 ACD, the Commission reviews the results of the Docket No. R2013-1 price adjustment. Many workshare discounts that were at or below 100 percent of the FY 2011 cost avoidance passed through more than 100 percent of the FY 2013 cost avoidances.

The Postal Service observes that these above 100 percent passthroughs result from the lag between estimation of new cost avoidances and pre-existing discounts.[2] The Postal Service recognizes that there is no statutory exception that addresses this timing issue. Consequently, the Postal Service does not rely on statutory worksharing exceptions to justify certain workshare discounts that pass through more than 100 percent of their avoided costs. *Id.*

The Postal Service contends that adjusting prices now to bring passthroughs to 100 percent would be inefficient and disruptive to both the Postal Service and its customers. *See* Response to CHIR No. 2, question 11. The Postal Service asserts that if it had been required to adjust discounts when the new cost data became available, it would have had to choose between two problematic options. The first option would have been to delay the implementation date for new rates in order to implement the prices that correct the workshare passthroughs in conjunction with the prices approved in Docket Nos. R2013-10 and R2013-11. A delay in implementation would have decreased the revenue the Postal Service would collect in FY 2014. The second option would have been to have an additional price adjustment a few months after the January 26 implementation of the Docket Nos. R2013-10 and R2013-11 prices. This option would have required "the Postal Service and industry to incur additional programming and implementation costs." *Id.*

The Postal Service does not offer a remedy to address the above 100 percent passthroughs that result from relying on outdated data for setting discounts. In the FY 2012 ACD, the Commission noted a Public Representative suggestion that cost avoidances in future years can be projected in advance of the ACR in the Postal Service's price adjustment filing. FY 2012 ACD at 80. *Because the timing of price adjustments is not a statutory exemption for passthroughs over 100 percent, the Postal Service should consider different approaches for setting workshare discounts, including projecting cost avoidances, that may reduce the*

[2] FY 2013 ACR at 12, 14, 26, 36.

number of discounts with passthroughs above 100 percent resulting from the timing of price adjustments. Alternatively, the Postal Service should consider revising the schedule of market dominant price adjustments.

Automation AADC Categories

The Postal Service did not use the approved methodology for calculating the costs avoided for First-Class Mail Automation AADC Letters, First-Class Mail Automation AADC Cards and Standard Mail Automation Letters.[3] It calculates the cost avoidance as the difference in cost between the Mixed AADC category and the volume weighted hybrid of the AADC and 3-Digit categories. The Postal Service argues that the weighted average of AADC/3-Digit costs should be used not only as a benchmark for the calculation of 5-Digit prices, but also for the calculation of the cost avoidance for the AADC category. Response to CHIR No. 5, question 9.[4] It contends that "it makes no sense to have a different cost avoidance for AADC than for 3-Digit, when they represent just one price cell." *Id.*

In Docket No. RM2012-6, the Commission approved the hybrid AADC/3-Digit costs as the benchmark for First-Class Mail 5-Digit Automation Letters, First-Class Mail 5-Digit Automation Cards and Standard Mail 5-Digit Automation Letters. In that docket, the Commission made no changes to the calculation of the AADC categories. The cost avoidance calculation for the AADC categories is calculated as the cost differential between the Mixed AADC category and the AADC category.

This ACD reflects only workshare methodologies approved by the Commission prior to the filing of the ACR. The appropriate means for changing an analytical principle, such as the methodology to calculate passthroughs for the AADC categories, is to petition for a rulemaking.

The remainder of this chapter discusses workshare discounts that exceed avoided cost by class of mail. There is also a short discussion of preferred rates at the end of this chapter.

WORKSHARE DISCOUNTS

First-Class Mail

The following nine workshare 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) AADC 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.

[3] Pitney Bowes notes that the Postal Service did not use the Commission-approved methodology in its passthrough calculation for the First-Class Mail Automation AADC categories. Pitney Bowes Comments at 3.

[4] Docket No. ACR2013, Responses of the United States Postal Service to Questions 1-3.b, 4-5, and 7-12 of Chairman's Information Request No. 5, February 11, 2014 (Response to CHIR No. 5).

The discounts for QBRM Letters and Cards are 113.3 percent of avoided costs. The Postal Service asserts that the excessive passthroughs result from a lag between estimation of new cost avoidances and the setting of discounts. FY 2013 ACR at 11. The Postal Service has not provided a statutory reason to justify the excessive passthroughs. *See* 39 U.S.C. 3622(e). *The Commission finds that the discounts for both QBRM Letters and Cards are out of compliance for FY 2013. The Postal Service must either align the QBRM Letters' discount with avoided costs during the next general market dominant price adjustment, or provide support for an applicable statutory exception.* With regard to the discount for QBRM Cards, the Postal Service's price change in Docket No. R2013-11 aligns the discount with avoided cost; therefore, no further action is required.

Discounts for Automation Mixed AADC Letters and Automation AADC Letters reflect a passthrough of 103.8 percent and 105 percent of avoided costs, respectively. The Postal Service has not provided a statutory reason to justify the excessive passthroughs.[5] *The Commission finds that the discounts are out of compliance for FY 2013. The Postal Service's price change in Docket No. R2013-11 aligns the Automation Mixed AADC Letters' discount with avoided cost; therefore, no further action is required. The Postal Service must either align the Automation AADC Letters' discount with avoided costs during the next general market dominant price adjustment, or provide support for an applicable statutory exception.*

Automation Mixed AADC Cards and Automation AADC Cards reflect a passthrough of 176.9 percent and 109.1 percent of avoided costs, respectively.[6] The Postal Service has not provided a statutory reason to justify the excessive passthroughs. *See* 39 U.S.C. 3622(e); FY 2013 ACR at 12 and Response to CHIR No. 5, question 9. *The Commission finds that the discounts are out of compliance for FY 2013. The Postal Service must either align the Automation Mixed AADC Cards' and Automation AADC Cards' discounts with avoided costs during the next general market dominant price adjustment, or provide support for an applicable statutory exception.*

The Postal Service calculates the following passthroughs of avoided costs for automation flats: Automation ADC Flats, 140.8 percent; Automation 3-Digit Flats, 127.8 percent; and Automation 5-Digit Flats, 133.3 percent. The Postal Service asserts these passthroughs are necessary to mitigate rate shock.[7] The Postal Service provides a range of rate increases (10.1 percent to 21.2 percent) necessary to bring Automation Flats (ADC, 3-Digit, and 5-Digit) passthroughs to 100 percent. However, it provides no explanation as to the adverse effects those increases would have on users of these mail categories. *Id*. For 5-Digit Automation Flats, the Postal Service argues that it would require an additional 4 cent decrease in the discount from the approved Docket No. R2013-10 discount to bring the passthrough to 100 percent of costs avoided. FY 2013 ACR at 15. Again, the Postal Service does not explain the nature or extent of the rate shock a lower passthrough would cause.

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[5] *See* 39 U.S.C. 3622(e); FY 2013 ACR at 12; Responses of the United States Postal Service to Questions 1-3.b, 4-5, and 7-12 of Chairman's Information Request No. 5, February 11, 2014 (Response to CHIR No. 5).

[6] Pitney Bowes urges the Commission to use the First-Class Mail Flats cost avoidance model as proposed in Docket No. RM2014-1 (Proposal 8) and updated in USPS-FY13-11, in calculating passthroughs for the First-Class Mail Flats categories. Pitney Bowes Comments at 4.

[7] *See* 39 U.S.C. 3622(e)(2)(B); Responses of the United States Postal Service to Questions 1-11 of Chairman's Information Request No. 2, January 23, 2014 (Response to CHIR No. 2).

The Postal Service's use of the "rate shock" exception is not sufficiently supported. *The Commission finds that the Postal Service has not demonstrated that Automation ADC Flats, Automation 3-Digit Flats, and Automation 5-Digit Flats qualify for the exception. The Commission finds that these discounts are out of compliance for FY 2013. The Postal Service must either align the discounts with avoided costs during the next general market dominant price adjustment, or adequately provide support for an applicable statutory exception.*

Table II-1
First-Class Mail
Workshare Discounts and Benchmarks

Type of Worksharing (Benchmark)	FY 2013 Year-End Discount (cents)	Unit Cost Avoidance (cents)	Passthrough
First-Class Mail Automation Letters			
Barcoding & Presorting			
Automation Mixed AADC Letters (Metered Letters)	5.5	5.3	103.8%
Automation AADC Letters (Automation Mixed AADC Letters)	2.1	2.0	105.0%
Automation 3-digit Letters (Automation AADC Letters)	0.0	0.4	0.0%
Automation 5-digit Letters (Hybrid Automation AADC/3-digit Letters)	2.4	2.9	82.8%
First-Class Mail Non-automation Letters			
Barcoding			
Non-automation Presort Letters (Metered Letters)	2.7	6.5	41.5%
First-Class Mail Single-Piece Letters			
Qualified Business Reply Mail			
Barcoding			
QBRM (Handwritten Reply Mail)	1.7	1.5	113.3%
First-Class Mail Automation Cards			
Barcoding & Presorting			
Automation Mixed AADC Cards (Non-automation Presort Cards)	2.3	1.3	176.9%
Automation AADC Cards (Automation Mixed AADC Cards)	1.2	1.1	109.1%
Automation 3-digit Cards (Automation AADC Cards)	0.0	0.2	0.0%
Automation 5-digit Cards (Hybrid Automation AADC/3-digit Cards)	1.2	1.5	80.0%
First-Class Mail Single-Piece Cards			
Qualified Business Reply Mail			
Barcoding			
QBRM (Handwritten Reply Cards)	1.7	1.5	113.3%
First-Class Mail Automation Flats			
Barcoding & Presorting			
Automation ADC Flats (Automation Mixed ADC Flats)	10.0	7.1	140.8%
Automation 3-digit Flats (Automation ADC Flats)	4.6	3.6	127.8%
Automation 5-digit Flats (Automation 3-digit Flats)	18.8	14.1	133.3%

Periodicals

Twelve Periodicals Outside County passthroughs, identified in Table II-2 below, exceeded 100 percent in FY 2013. No Periodicals Within County passthroughs exceeded 100 percent in FY 2013.

Table II-2
Periodicals Workshare Discounts Exceeding Avoided Cost in FY 2013

Outside County				
Type of Worksharing		Avoided Cost	Discount/ (Surcharge)	Passthrough
Presorting (cents/piece)				
1	Machinable Non-automation 5D Flats	8.4	10.3	122.6%
2	High Density	2.5	3.3	132.0%
3	Machinable Automation 5D Flats	7.4	9.0	121.6%
4	Non-machinable Non-auto ADC Flats	9.5	12.1	127.4%
5	Non-machinable Non-automation 3D/SCF Flats	(2.5)	7.8	-312.0%
6	Non-machinable Automation ADC Flats	9.5	10.0	105.3%
7	Non-machinable Automation 3D/SCF Flats	(2.2)	6.4	-290.9%
Barcoding (cents/piece)				
8	Machinable Automation MADC Flats	3.1	3.3	106.5%
9	Non-machinable Automation MADC Flats	0.3	4.7	1566.7%
Presorting Automation Letters (dollars/piece)				
10	ADC Automation Letter	1.5	4.1	266.3%
11	3-Digit Automation Letter	0.3	2.1	603.8%
12	5-Digit Automation Letter	2.0	6.4	313.8%

Source: PRC-ACR2013-LR-3.

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 educational, cultural, scientific, or informational (ECSI) value. FY 2013 ACR at 33. All the passthroughs for Within County and Outside County, and all the bundle/container price-cost ratios are contained in Chapter 2.

Public Representative Comments

The Public Representative notes that 12 of 20 Outside County workshare discounts exceed avoided costs. PR Comments at 39.

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).[8] None of the passthroughs for these workshare discounts was reduced toward 100 percent in the most recently approved prices in Docket No. R2013-10 and Docket No. R2013-11.[9] While the Postal Service justifies these workshare discounts based on 39 U.S.C. 3622(e)(2)(C), other factors and objectives highlight the importance of sending efficient pricing signals. The Postal Service has not changed the pricing relationships between workshare categories since FY 2009. Better aligning discounts with avoided costs would allow mailers and the Postal Service to maximize efficiency. 39 U.S.C. 404(b) authorizes the Governors to establish "reasonable and equitable" rates "under best practices of honest, efficient, and economical management." The growing disconnect between Periodicals costs and Periodicals prices raises concerns for both clauses.

In the FY 2012 ACD, the Commission noted that Periodicals workshare discounts increasingly reflect outdated cost relationships. Specifically, the Commission noted that the FY 2012 discount for the pre-barcoding of Non-machinable Automation Mixed area distribution center (Mixed ADC) Flats of 4.5 cents was 45 times the avoided cost of 0.1 cent. As the Commission further noted, this discount highlights that the Periodicals pricing structure has not been updated to reflect operational realities. Periodicals mail entered as Non-machinable Automation Mixed ADC Flats did not meet the machinability standard for Periodicals. The Postal Service offers a discount from Non-machinable Non-automation Mixed ADC Flats to Non-machinable Automation Mixed ADC Flats for mailers pre-barcoding their mail. This barcode is only valuable to the Postal Service when the discounted mail is processed on automation equipment. The Postal Service has historically used the Upgraded Flats Sorting Machine (UFSM) to sort flats that cannot be processed on the Automated Flats Sorting Machine (AFSM).[10]

As part of facility modernization efforts, most notably the Mail Processing Network Rationalization, the Postal Service has removed the UFSM from usage. In FY 2009, 6.1 percent of Periodicals were sorted on the UFSM. In FY 2013, 0.3 percent of Periodicals were sorted using only the UFSM. The removal of UFSM from the postal network has eroded the value of incentivizing mailers to pre-barcode non-machinable flats. In FY 2009, the avoided cost of pre-barcoding flats processed on the USFM was 3.3 cents. In FY 2013, the discount for the pre-barcoding of Non-machinable Automation Mixed ADC Flats was 15 times the avoided cost. The source of the improvement was an increase in avoided cost from 0.1 cent to 0.3 cent.[11] Notably, the Postal Service increased the discount for this worksharing activity in FY 2013, from 4.5 cents to 4.7 cents.

[8] 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.

[9] *See* Docket No. R2013-10, Library Reference PRC-LR-R2013-10/2, November 21, 2013.

[10] AFSM machinability standards are used to set Periodicals machinability standards.

[11] *See* Docket No. RM2014-1, Petition of the United States Postal Service for the Initiation of a Proceeding to Consider Proposed Changes in Analytical Principles (Proposals Six Through Eight), November 8, 2013, Proposal 8.

By sending inefficient price signals to mailers, the Postal Service is distorting mail preparation incentives. The example of the discount for the pre-barcoding of Non-machinable Automation Mixed ADC Flats highlights the many effects of these inefficient price signals. The price of Non-machinable Automation Mixed ADC Flats is the benchmark from which all Non-machinable Automation prices are set. For preparing Non-machinable Automation ADC Flats, mailers receive a discount of 10 cents compared to the avoided cost of 9.5 cents, for a passthrough of 105.3 percent, as detailed in line 6 in Table II-2. Because the benchmark for Non-machinable Automation Mixed ADC Flats is priced with a discount of 4.4 cents in excess of avoided cost, mailers are sent an inefficient price signal to pre-barcode all rate categories in the Non-machinable Automation worksharing tree.

The two Outside County rate elements with the most volume are Automation Machinable 5-Digit Flats and Carrier Route Basic Flats. Table II-3 details the passthrough for 5-Digit Machinable Automation pieces and for Basic Carrier Route pieces since FY 2008.

Table II-3
Carrier Route and 5-Digit Automation Passthroughs

	Passthroughs					
	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013
CR Basic	88.15%	71.52%	71.05%	69.48%	71.33%	77.70%
5-Digit Automation	61.37%	96.63%	102.38%	106.17%	104.82%	121.62%

Sources: Docket Nos. ACR 2009 –ACR 2013, PRC Periodical Library References.

The 9.8 cent differential between 5-Digit and Carrier Route has remained unchanged since FY 2008. The Joint Periodicals Mail Study found that Carrier Route presorted pieces were among "the rate elements that provide the most contribution per piece."[12] The Periodicals pricing structure provides 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.

The Postal Service did not offer Flats Sequencing System (FSS) specific prices in FY 2013. In Docket No. R2013-10, the Postal Service added an FSS discount and amended FSS mail preparation rules. As the Commission noted, the Postal Service "should investigate how it can increase cost coverage with its new FSS prices."[13]

[12] Periodicals Mail Study, Joint Report of the United States Postal Service and Postal Regulatory Commission, September 2011, at 25 (Periodicals Mail Study).

[13] Docket No. R2013-10, Order on Price Adjustments for Market Dominant Products and Related Mail Classification Changes, November 21, 2013, at 88 (Order No. 1890).

As Postal Service operations have changed, Periodicals prices have become increasingly detached from costs. In FY 2009, five discounts for Periodicals exceeded avoided costs, and three of those discounts were for low-volume letter rate categories. In FY 2013, over 50 percent of Periodicals worksharing categories had passthroughs over 100 percent. Worksharing discounts that do not reflect cost relationships lead to Periodicals mailers paying disproportionately unequal amounts of contribution. Discounts in excess of avoided cost also contribute to Periodicals revenues not covering costs.

39 U.S.C. 3622 (b)(1) encourages maximizing incentives to reduce costs and section 3622(c)(7) encourages pricing that reflects the degree of mail preparation and its corresponding effect on reducing Postal Service costs. Each of these objectives and factors recognizes that pricing incentives can lower costs.

Taken together, the current Periodicals worksharing relationships do not maximize incentives that would reduce Postal Service costs. There are too many workshare discounts (and container/bundle charges discussed below) that are above and below the most efficient price. Disregarding the total negative contribution of Periodicals for the moment, if every price were set in accordance with an efficient approach, every individual Periodical piece would have a price that covers the cost it imposes on the Postal Service plus make the same contribution per piece that every other Periodical piece would contribute. All other variables held constant, this approach should maximize the contribution of Periodicals as a whole.

As an example, consider the worksharing discount for the Non-machinable Automation Mixed ADC Flats discussed above. The discount exceeds the avoided cost by 4.4 cents, which means that the price paid by mailers of this minimally presorted, barcoded piece is 4.4 cents below the efficient price and results in a price that does not cover the cost it imposes on the Postal Service. Yet the Postal Service increased the discount in FY 2013. This mail category amounted to only 14.3 million pieces in FY 2013, but it provides an example of how the Postal Service does not take advantage of opportunities to maximize contribution. The Postal Service would be better served by charging a price that reflects the costs imposed on the Postal Service.

However, the Postal Service cannot change one price in isolation. Because setting prices within a class is a zero-sum game, changing one price results in a cascade of changes. Other prices must be increased or decreased to offset the revenue losses or gains from a poorly set discount, which produces, with little exception, an entire set of inefficient prices. Conversely, one price cannot be moved to its efficient level without taking into account the cascading effect. Thus, a set of Periodicals prices that maximizes efficient mailer preparation cannot be achieved in one set of price changes.

In past ACDs, the Commission has encouraged the Postal Service to begin adjusting its prices to increase the incentives for efficient mailer behavior.[14] However, the Postal Service has instead used

[14] Docket No. ACR2009, FY 2009 Annual Compliance Determination Report, March 29, 2010, at 76 (FY 2009 ACD); Docket No. ACR 2010, FY 2010 Annual Compliance Determination Report, March 29, 2011, at 96, 97 (FY 2010 ACD); Docket No. ACR 2011, FY 2011 Annual Compliance Determination Report, March 28, 2012, at 108, 110 (FY 2011 ACD); Docket No. ACR 2012, FY 2012 Annual Compliance Determination Report, May 7, 2013, at 100, 101 (FY 2012 ACD).

an across-the-board approach to increasing Periodicals rates, which has not incentivized mailers to increase mail preparation or pay for the costs imposed on the Postal Service. In this regard, it appears the Postal Service bears much of the responsibility for the inability of Periodicals prices to cover more of their attributable costs. Had the Postal Service begun to move discounts incrementally toward a more efficient set of prices in Docket No. R2008-1 and continued to improve prices incrementally through Docket No. R2013-10, the negative contribution might have been reduced substantially. *Thus, the Postal Service should begin to remedy this issue by judicious use of its pricing flexibility, while being mindful of the cascading effect of changing prices.*

The Postal Service has the tools to balance a set of price adjustments that move toward maximizing efficiency. It has a database that will allow it to test alternative sets of prices so that it can minimize, but not avoid, adverse price impacts on its customers. The entire postal community, including Periodicals mailers, has an interest in maintaining a viable Postal Service and paying a fair share of Postal Service expenses. The negative contribution of Periodicals must be reduced further to contribute to the financial well-being of the Postal Service. This must begin in the next market dominant price adjustment.

The Postal Service should use the time between the issuance of this ACD and the next market dominant price adjustment to design an alternative set of Periodicals prices while continuing to improve operations to reduce the costs of handling flat-shaped mail.

For these reasons, the Commission again 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. In the next market dominant price adjustment, the Postal Service must describe how it is implementing the Commission's pricing recommendation set forth herein.

Standard Mail

During FY 2013, four Standard Mail worksharing discounts differed between the commercial and nonprofit categories for the same presort and automation level. Two of these appear in the discussion of the High Density products and the other two occur in the discussion of the Flats product. *See* section on Letters and Flats, *infra*. Other workshare discounts that were not equal for nonprofit and commercial corresponding workshare activities were equalized in Docket No. R2013-1. *See* Order No. 1890 at 82-84[15] and Order No. 1902 at 3-4.[16]

Table II-4 shows the passthroughs by shape for the High Density Presort level and for dropship Carrier Route, High Density, and Saturation categories. The table includes the presort discounts for Nonprofit High Density Letters and Nonprofit High Density Flats. These discounts differ from their commercial counterparts. All of the passthroughs, including the separate nonprofit discounts, are less than 100

[15] Docket No. R2013-10, Order on Price Adjustments for Market Dominant Products and Related Mail Classification Changes, November 21, 2013 (Order No. 1890).

[16] Docket No. R2013-10, Order Approving Amendments to Notice of Market Dominant Price Adjustment, December 11, 2013 (Order No. 1902).

percent. In the last ACD, the Commission directed the Postal Service to equate the discounts in the next rate case or provide a justification for not doing so. In Docket No. R2013-10, the Postal Service equated the high density discounts for the nonprofit and commercial categories. Thus, in this ACD there is no need for further action.

Table II-5, Table II-6, and Table II-7 on page 29-33 show the passthroughs for the remaining products: Letters, Flats, and Parcels. Table II-6 includes two nonprofit workshare discounts that differ from their commercial counterparts. Unless the line items in this table are identified as nonprofit or commercial, the discounts apply equally to the nonprofit and commercial categories.

The discounts for 17 workshare categories exceed avoided costs. In its discussion of discounts that exceed avoided cost, the Commission first discusses Letters, then Flats, and finally the Parcels product.

Letters

Five discounts for Standard Mail Letters exceeded avoided costs in FY 2013: (1) Automation Mixed AADC Letters; (2) Non-automation 3-Digit Non-machinable Letters; (3) Non-automation 5-Digit Non-machinable Letters; (4) Non-automation ADC Non-machinable Letters; and (5) Automation AADC Letters.

Although Automation Mixed AADC Letters had a passthrough of 400 percent, avoided costs improved by 0.5 cents, from a negative 0.3 cents in FY 2012 to a positive 0.2 cents in FY 2013. In the FY 2012 ACD, the Commission requested that the Postal Service investigate the reason for the negative cost avoidance. FY 2012 ACD at 123. The Postal Service contends that the negative cost avoidance was due to a temporary problem affecting underlying productivity measurement. FY 2013 ACR at 22 n.15.

The Postal Service justifies the excessive Automation Mixed AADC Letters passthrough pursuant to section 3622(e)(2)(D), as this barcoding discount encourages mailers to provide an Intelligent Mail barcode (IMb) on their mailpieces, which improves operational efficiency. In addition, the Postal Service intends to eliminate the portion of the discount above avoided cost over time. *Id*. at 22.

The Commission concludes that this discount is adequately justified pursuant to section 3622(e)(2)(D) as encouraging mailers to utilize IMb barcodes which should improve operational efficiency.

Non-automation 3-Digit Non-machinable Letters and Non-automation 5-Digit Non-machinable Letters had passthroughs of 161.9 percent and 137.7 percent, respectively.

The Postal Service justifies these passthroughs by citing the exceptions listed in 39 U.S.C. 3622(e)(2)(B) and 3622(e)(2)(D). The Postal Service indicates that aligning the discounts and avoided costs would result in increases for Non-automation 3-Digit Non-machinable letters of 10.4 percent and Non-automation 5-Digit Non-machinable letters of 20.3 percent. To avoid price increases that could result in rate shock, the Postal Service intends to continue reducing the discount until the passthrough reaches 100 percent. In addition, the Postal Service also asserts that these discounts encourage mailers to enter more finely presorted mail. Given the fewer number of processing plants, the Postal

Service contends that reduction of the passthroughs could lead to additional allied operations, manual processing, and transportation costs. *Id.* at 21-22.

The Public Representative contends that the Postal Service should not rely upon 39 U.S.C. 3622(e)(2)(B) because it stated that it would not be feasible to alter rates. Without any rates being altered, there would be no rate shock. PR Comments at 40. As for the Postal Service's explanation pursuant to 39 U.S.C. 3622(e)(2)(D), the Public Representative indicates that he supports more efficient mail preparation, but is concerned that the Postal Service has not provided sufficient evidence of how excessive passthroughs, as opposed to other factors, are responsible for improved mail preparation. He recommends that the Commission only allow excessive passthroughs pursuant to 39 U.S.C. 3622(e)(2)(D) when there is sufficient evidence that the discount results in a substantial reduction in avoided cost. He also recommends that "the Postal Service and/or the Commission investigate whether or not there are diminishing marginal benefits from continued and/or increasing passthroughs greater than 100 percent for a product." *Id*. at 41.

The Commission concludes that these discounts are adequately justified pursuant to section 3622(e)(2)(D) as encouraging operational efficiency because mailers will be incentivized to enter more finely presorted mail. However, the Commission encourages the Postal Service to investigate the additional costs it has listed, such as allied operations, manual processing, and transportation costs, to ensure the avoided costs model accurately reflects the additional cost savings for having more finely presorted mail.

Non-automation ADC Non-machinable Letters had a passthrough of 135.7 percent. The Postal Service notes that the cost avoidance increased from 7.9 cents in FY 2011 to 8.0 cents in FY 2012, decreased to 7.0 cents in FY 2013, and effective January 26, 2014, the discount was reduced 0.2 cents to 9.3 cents. It contends that "given the volatility of cost avoidances, the progress made in recent price changes, and the Commission's acceptance of a 116.3 percent passthrough in Docket No. R2013-10, it is not relying on any of the statutory exceptions." FY 2013 ACR at 20. In addition, the Postal Service "…intends to eliminate the portion of the discount above avoided costs, as soon as practicable, while taking into account relevant business considerations." *Id.*

The Public Representative does not agree with the Postal Service that it will be able to reduce the passthrough to 100 percent in the future. He contends that the Postal Service "is able to slightly reduce discounts, but recent history has shown that avoided cost changes (usually reductions) regularly overwhelm discount reductions and yield increasing, not decreasing, passthroughs." PRC Comments at 40.

The Commission finds that the discount for Non-automation ADC Non-machinable Letters is out of compliance for FY 2013. The Postal Service must either align the discount with avoided costs when it files its next general market dominant price adjustment, or adequately support the discounts with an applicable statutory exception.

Automation AADC Letters had a passthrough of 106.7 percent. The Postal Service did not use the approved methodology for calculating the costs avoided for Automation AADC Letters. It calculates the cost avoidance as the difference in cost between the Mixed AADC category and the volume weighted hybrid of the AADC and 3-Digit categories. The Postal Service argues that the weighted average of AADC/3-Digit costs should be used not only as a benchmark for the calculation of 5-Digit prices, but also for the calculation of the cost avoidance for the AADC category. *See* Postal Service Response to CHIR No. 9. It contends that "it makes no sense to have a different cost avoidance for AADC than for 3-Digit, when they represent just one price cell."[17] *Id.* The Postal Service has not provided a statutory exception to justify the excessive passthrough. *Id.*

This ACD reflects only methodologies approved by the Commission prior to the filing of the ACR. The Postal Service may file a petition to initiate proceedings to consider changes to the methodology for the calculation of cost avoidances for the AADC categories that, if approved, may be used in future ACDs.

The Commission finds, using the approved methodology, that the discount for Automation AADC Letters is out of compliance for FY 2013. The Postal Service must either align the discounts with avoided costs when it files its next general market dominant price adjustment, or adequately support the discounts with an applicable statutory exception.

Flats

Seven Standard Mail Flats discounts exceeded their avoided costs in FY 2013. This includes two separate discounts for the nonprofit category, two separate discounts for the commercial category, and three discounts that apply equally to both: (1) Non-automation 3-Digit (nonprofit); (2) Automation 5-Digit (nonprofit); (3) Non-automation 3-Digit (commercial); (4) Automation 5-Digit (commercial); (5) Automation 3-Digit; (6) Non-automation 5-Digit; and (7) Automation Mixed AADC.

Nonprofit discounts for Non-automation 3-Digit and Automation 5-Digit Flats had passthroughs of 125.7 and 104.7 percent, respectively. Commercial discounts for Standard Mail Non-automation 3-Digit Flats (commercial) and Automation 5-Digit Flats (commercial) had passthroughs of 142.9 percent and 108.1 percent, respectively. For these four discounts, the Postal Service does not provide any statutory exception for these discounts exceeding avoided costs. Instead, the Postal Service plans to align these discounts with avoided costs during future market dominant price adjustments.[18]

While the Commission finds that these four discounts are out of compliance for FY 2013, the Commission notes that two of the discounts, Nonprofit Non-automation 3-Digit Flats and Commercial Automation 5-Digit Flats, have passthroughs of 100.0 percent after the approval of Docket No. R2013-10.[19] For Nonprofit Automation 5-Digit Flats and Commercial Non-automation 3-Digit Flats, the Postal Service must either align the discounts with avoided costs when it files its next general market dominant price adjustment, or adequately support an applicable statutory exception.

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[17] Docket No. ACR2013, Response of the United States Postal Service to Chairman's Information Request No. 9, February 27, 2014 (Response to CHIR No. 9).

[18] Docket No. ACR2013, Response of the United States Postal Service to Questions 1-11 of Chairman's Information Request No. 2, January 23, 2014, question 11. *See also* FY 2013 ACR at 25-26.

[19] *See* Docket No. R2013-10, United States Postal Service Notice of Market Dominant Price Adjustment, Attachment B at 8 and Order No. 1902 at 3-4.

The passthrough for Automation 3-Digit Flats was 117.9 percent. Like the four discounts above, the Postal Service does not provide any statutory exception for this discount exceeding avoided costs. Instead, the Postal Service plans to align this discount with avoided costs during future market dominant price adjustments.[20]

For Automation 3-Digit Flats, the Commission finds the discount is out of compliance. 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.

The presort discount for Non-automation 5-Digit Flats had a passthrough of 132.2 percent for FY 2013. In Docket No. R2013-1, the Commission found that the proposed discount of 7.8 cents was aligned with the avoided cost. However, during consideration of Docket No. R2013-10, the discount had a passthrough of 120.8 percent. The Postal Service notes that "the cost avoidance fell significantly, to 5.9 cents, meaning that the passthrough will likely remain above 100 percent in FY 2014." FY 2013 ACR at 27. It contends that aligning the discount with cost avoidance would require an 11 percent price increase. In order to avoid a significant price increase that could result in rate shock, the Postal Service intends to continue reducing the discount until the passthrough reaches 100 percent. *Id.*

The Commission finds the Postal Service has demonstrated that this excessive discount is adequately justified pursuant to 39 U.S.C. 3622(e)(2)(B) as it is necessary to mitigate rate shock and will be phased out over time.

The Automation Mixed ADC flats discount had a passthrough of 305.6 percent in FY 2013. The avoided cost decreased from 4.5 cents in FY 2012 to 1.8 cents in FY 2013. The Postal Service indicates that " [o]n January 26, 2014, this discount will decrease to 4.9 cents from 5.5 cents." *Id.* In addition, the Postal Service justifies the excessive pre-barcoding discount for Standard Mail Automation Mixed ADC Flats under 39 U.S.C. 3622(e)(2)(D), a reduction in the discount would impede operational efficiency. In previous ACRs the Postal Service explained that the excessive passthrough is necessary to encourage pre-barcoding of flats as a way to support the implementation of the FSS program. While the Postal Service's deployment of FSS machines has been completed, it indicates that there is still a need for a pre-barcoding incentive. The Postal Service notes its intention to continue to phase this discount out over time. *Id.*

The Public Representative argues that the Postal Service should provide evidence as to why a discount that has increased its passthrough from 239 percent to 305.6 percent is needed a year after the deployment of the FSS has been completed. PR Reply Comments at 42. Valpak agrees with the Public Representative and questions why the Postal Service is providing such large workshare discounts to those mailers using a product that is causing large financial losses to the Postal Service. Valpak Reply Comments at 34.

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[20] Docket No. ACR2013, Response of the United States Postal Service to Questions 1-11 of Chairman's Information Request No. 2, January 23, 2014, question 11. *See also* FY 2013 ACR at 25-26.

The Commission finds this discount is adequately justified pursuant to 39 U.S.C. 3622(e)(2)(D), as a reduction in the discount may impede operational efficiency and discourage the use of pre-barcoding. In addition, the Postal Service intends to continue phasing this discount out over time.

Parcels

Five worksharing discounts for Standard Mail Parcels exceeded their avoided costs in FY 2013. The following two presort discounts exceeded avoided costs: (1) NDC Irregular Parcels[21] at 36.5 cents, and (2) NDC Marketing Parcels at 41.4 cents. In addition, the following three pre-barcoding discounts exceeded their avoided costs: (1) Mixed NDC Machinable Barcoded Parcels at 6.4 cents; (2) Mixed NDC Irregular Barcoded Parcels at 6.4 cents; and (3) Mixed NDC Barcoded Marketing Parcels at 6.4 cents.[22]

The Postal Service justifies the passthroughs of the two presort discounts by citing the exception found in 39 U.S.C. 3622(e)(2)(B). It contends that immediately aligning the discount for NDC Irregular Parcels with avoided cost would require a 19 percent price increase. In addition, the Postal Service intends to continue phasing out the discount until the passthrough reaches 100 percent. *Id*.

The Public Representative reiterates his claim that the Postal Service should not rely upon 39 U.S.C. 3622(e)(2)(B), rate shock, when it contends that it is unable to modify prices. If there are no rates to alter, then there is no rate shock. PR Comments at 43.

The Commission finds the Postal Service has demonstrated that these excessive discounts are adequately justified pursuant to 39 U.S.C. 3622(e)(2)(B) as they are necessary to mitigate rate shock and will be phased out over time.

As for the three pre-barcoding discounts, the Postal Service justifies these discounts in excess of estimated avoided cost on the basis of efficient operations, citing section 3622(e)(2)(D). As discussed in previous ACRs, the Postal Service wants to promote a fully prebarcoded incoming parcel mailstream which would allow the elimination of keying stations on parcel sorters, thereby increasing the efficiency of postal operations. FY 2013 ACR at 29. 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 Public Representative contends that the same passthroughs were 164.1 percent in FY 2013 and have remained relatively constant compared to FY 2012. He therefore accepts the Postal Service's proposed exceptions. PR Comments at 43.

[21] For this category, the discount applies only to nonprofit. Its commercial counterpart was moved to the Competitive Product List. *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.

[22] *Id.* Parcel dropship cost avoidances increased substantially between FY 2012 and FY 2013. The Postal Service characterizes these cost avoidances as anomalous and is investigating an alternative methodology to improve the costing. Docket No. 2013ACR, United States Postal Service Response to Question 1 of Chairman's Information Request No. 11, March 6, 2014.

The Commission finds that for FY 2013, the pricing of the pre-barcoding discounts for Standard Mail Parcels is justified under 39 U.S.C. 3622(e)(2)(D) on the basis that it promotes a fully pre-barcoded incoming parcel mailstream which will improve operational efficiency.

Table II–4
Standard Mail Carrier Route, High Density, and Saturation by Shape

	FY 2013		
Type of Workshare (Benchmark)	Year-End Discount (cents)	Unit Cost Avoidance (cents)	Passthrough
Commercial Presorting (cents/piece)			
High Density Letters	7.7	17.5	44.0%
(Carrier Route Letters)			
High Density Flats	5.1	6.6	77.3%
(Carrier Route Flats)			
Nonprofit Presorting (cents/piece)			
High Density Letters	7.4	17.5	42.3%
(Carrier Route Letters)			
High Density Flats	4.9	6.6	74.2%
(Carrier Route Flats)			
Dropship (cents/pound)			
DNDC Letters	16.1	31.5	51.1%
(Origin Letters)			
DSCF Letters	20.9	39.5	52.9%
(Origin Letters)			
DNDC Flats	16.1	18.5	87.0%
(Origin Flats)			
DSCF Flats	20.9	21.6	96.8%
(Origin Flats)			
DDU Flats	25.2	26.5	95.1%
(Origin Flats)			

Source: PRC-ACR2013-LR-2.

Table II-5
Standard Mail Letters and Flats (Commercial and Nonprofit)
Presorting/Barcoding Workshare Discounts and Benchmarks

	FY 2013		
Type of Workshare (Benchmark)	**Year-End Discount (cents)**	**Unit Cost Avoidance (cents)**	**Passthrough**
Standard Mail Letters			
Standard Mail Automation Letters			
Presorting (cents/piece)			
Automation AADC Letters	1.6	1.5	106.7%
(Automation Mixed AADC Letters)			
Automation 3-digit Letters	0.0	0.3	0.0%
(Automation AADC Letters)			
Automation 5-digit Letters	1.9	2.0	95.0%
(Automation 3-digit Letters)			
Barcoding (cents/piece)			
Automation Mixed AADC Letters	0.8	0.2	400.0%
(Non-automation Machinable Mixed ADC Letters)			
Standard Mail Non-automation Letters			
Presorting (cents/piece)			
Non-automation AADC Machinable Letters	1.6	1.6	100.0%
(Non-automation Mixed AADC Machinable Letters)			
Non-automation ADC Non-machinable Letters	9.5	7.0	135.7%
(Non-automation Mixed ADC Non-machinable Letters)			
Non-automation 3-digit Non-machinable Letters	3.4	2.1	161.9%
(Non-automation ADC Non-machinable Letters)			
Non-automation 5-digit Non-machinable Letters	9.5	6.9	137.7%

Table II-5
Standard Mail Letters and Flats (Commercial and Nonprofit)
Presorting/Barcoding Workshare Discounts and Benchmarks (Cont.)

	FY 2013		
Type of Workshare (Benchmark)	**Year-End Discount (cents)**	**Unit Cost Avoidance (cents)**	**Passthrough**
(Non-automation 3-digit Non-machinable Letters)			
Standard Mail Flats			
Standard Mail Automation Flats			
Presorting (cents/piece)			
Automation ADC Flats	1.0	3.8	26.3%
(Automation Mixed ADC Flats)			
Automation 3-digit Flats	4.6	3.9	117.9%
(Automation ADC Flats)			
Commercial Automation 5-digit Flats	9.3	8.6	108.1%
(Automation 3-digit Flats)			
Nonprofit Automation 5-digit Flats	9.0	8.6	104.7%
(Automation 3-digit Flats)			
Barcoding (cents/piece)			
Automation Mixed ADC Flats	5.5	1.8	305.6%
(Non-automation Mixed ADC Flats)			
Standard Mail Non-automation Flats			
Presorting (cents/piece)			
Non-automation ADC Flats	3.7	4.2	88.1%
(Non-automation Mixed ADC Flats)			
Commercial Non-automation 3-digit Flats	5.0	3.5	142.9%
(Non-automation ADC Flats)			
Nonprofit Non-automation 3-digit Flats	4.4	3.5	125.7%
(Non-automation ADC Flats)			
Non-automation 5-digit Flats	7.8	5.9	132.2%
(Non-automation 3-digit Flats)			

Source: PRC-ACR2013-LR-2.

Table II-6
Standard Mail Parcels (Commercial and Nonprofit)
Presorting/Barcoding Workshare Discounts and Benchmarks

Type of Workshare (Benchmark)	Year-End Discount (cents)	FY 2013 Unit Cost Avoidance (cents)	Passthrough
Nonprofit Standard Mail Parcels			
Presorting (cents/piece)			
NDC Machinable Parcels	36.2	54.6	66.3%
(Mixed NDC Machinable Parcels)			
5-digit Machinable Parcels	26.0	62.2	41.8%
(NDC Machinable Parcels)			
NDC Irregular Parcels	36.5	19.5	187.2%
(Mixed NDC Irregular Parcels)			
SCF Irregular Parcels	35.6	43.8	81.3%
(NDC Irregular Parcels)			
5-digit Irregular Parcels	2.9	56.9	5.1%
(SCF Irregular Parcels)			
Barcoding (cents/piece)[1]			
Mixed NDC Machinable Barcoded Parcels[2]	6.4	3.5	182.9%
(Mixed NDC Machinable Non-barcoded Parcels)			
Mixed NDC Irregular Barcoded Parcels[2]	6.4	3.5	182.9%
(Mixed NDC Irregular Non-barcoded Parcels)			
Standard Mail Marketing Parcels			
Presorting (cents/piece)			
NDC Marketing Parcels	41.4	30.6	135.3%
(Mixed NDC Marketing Parcels)			
SCF Marketing Parcels	31.2	36.4	85.7%
(NDC Marketing Parcels)			
5-digit Marketing Parcels	6.8	54.9	12.4%
(SCF Marketing Parcels)			
Barcoding (cents/piece)[1]			
Mixed NDC Barcoded Marketing Parcels[2]	6.4	3.5	182.9%
(Mixed NDC Non-barcoded Marketing Parcels)			

Source: PRC-ACR2013-LR-2.

[1] The Postal Service charges a surcharge for non-barcoded pieces.

[2] 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 Bound Printed Matter (BPM) as a proxy. *See* PRC-ACR2013-LR-4, Excel file "2013 BPM MP," tab 'Barcode Savings.'

Table II-7
Standard Mail Letters, Flats, and Parcels (Commercial and Nonprofit) Dropship Discounts and Benchmarks

	FY 2013		
Type of Worksharing (Benchmark)	Year-End Discount (cents)	Unit Cost Avoidance (cents)	Passthrough
Standard Mail Letters			
Dropship (cents/pound)			
DNDC Letters	16.1	31.5	51.1%
(Origin Letters)			
DSCF Letters	20.9	39.5	52.9%
(Origin Letters)			
Standard Mail Flats			
Dropship (cents/pound)			
DNDC Flats	16.1	18.5	87.0%
(Origin Flats)			
DSCF Flats	20.9	21.6	96.8%
(Origin Flats)			
Nonprofit Standard Mail Machinable Parcels			
Dropship (cents/pound)			
DNDC Machinable Parcels	22.3	898.5	2.5%
(Origin Machinable Parcels)			
DSCF Machinable Parcels	46.2	1106.9	4.2%
(Origin Machinable Parcels)			
DDU Machinable Parcels	64.1	1141.5	5.6%
(Origin Machinable Parcels)			
Standard Mail Marketing Parcels			
Dropship (cents/pound)			
DNDC Marketing Parcels	22.3	898.5	2.5%
(Origin Marketing Parcels)			
DSCF Marketing Parcels	46.2	1106.9	4.2%
(Origin Marketing Parcels)			
DDU Marketing Parcels	64.1	1141.5	5.6%
(Origin Marketing Parcels)			
Nonprofit Standard Mail Irregular Parcels			
Dropship (cents/pound)			
DNDC Irregular Parcels	22.3	898.5	2.5%
(Origin Irregular Parcels)			
DSCF Irregular Parcels	46.2	1106.9	4.2%
(Origin Irregular Parcels)			
DDU Irregular Parcels	64.1	1141.5	5.6%
(Origin Irregular Parcels)			

Source: PRC-ACR2013-LR3

Package Services

The following three Package Services products offered workshare discounts in FY 2013: (1) Media Mail/Library Mail; (2) Bound Printed Matter (BPM) Flats; and (3) Bound Printed Matter (BPM) Parcels.

Media Mail/Library Mail

There were four discounts offered for Media Mail/Library Mail in FY 2013. Table II-8 shows the FY 2013 discounts, avoided costs, and passthroughs for Media Mail/Library Mail.

The Basic presort discount for the Media Mail/Library Mail categories exceeded avoided costs in FY 2013. The FY 2013 Basic presort passthroughs for Media Mail/Library Mail were 156.7 percent and 146.7 percent, respectively. The Postal Service justifies the FY 2013 passthroughs pursuant to section 3622(e)(2)(C) because Media Mail/Library Mail are categories consisting of mail matter of ECSI value. The Postal Service explains that it plans to move the discounts toward their unit cost avoidances over time, while avoiding any drastic changes that could cause rate shock. FY 2013 ACR at 35.

BPM Flats and BPM Parcels

In FY 2013, there were 15 discounts offered for BPM Flats and 12 discounts for BPM Parcels. Table II-9 and Table II-10 show the FY 2013 discounts, avoided costs, and passthroughs for BPM Flats and BPM Parcels, respectively.

The Destination Network Distribution Center (DNDC) dropship discount for BPM Flats and BPM Parcels exceeded unit avoided costs in FY 2013. The DNDC dropship passthrough was 121.4 percent for both products. *See* Tables II-9 and II-10. In Docket No. R2013-1, the Postal Service set the DNDC dropship discounts for BPM Flats and BPM Parcels equal to their respective unit avoided costs.[23] However, those discounts were set using FY 2011 unit avoided costs data. Since the Docket No. R2013-1 proceeding, the unit avoided costs of DNDC dropship discounts for BPM Flats and BPM Parcels decreased, resulting in above-100 percent passthroughs for FY 2013. The Postal Service plans to align the discounts with their unit avoided costs in its next price adjustment. FY 2013 ACR at 36; Response to CHIR No. 2, question 11.

The Postal Service also observes that in its most recent price adjustment that went into effect on January 26, 2014, the discounts for BPM Flats and BPM Parcels DNDC dropship were set equal to the latest available unit avoided costs data from FY 2012.[24] However, those discounts, while equivalent to the FY 2012 unit avoided costs, are still greater than the newly calculated unit avoided costs for FY 2013. Therefore, these discounts are likely to have above 100 percent passthroughs in the Postal Service's FY 2014 ACR. Consequently, the Postal Service believes that it does not need to rely on a statutory worksharing exception to justify above 100 percent pass throughs for BPM Flats and BPM

[23] *See* Docket No. R2013-1, Compliance Calculations for Package Services, Library Reference PRC-LR-R2013-1-4, November 16, 2012; Excel file "R2013-1 Package Services Worksharing.xlsx," which shows that the DNDC dropship discount and unit avoided costs were 17.0 cents for both BPM Flats and BPM Parcels.

[24] *See* Docket No. R2013-11, Price Adjustment Calculations for Package Services, Library Reference PRC-LR-R2013-11-6, December 24, 2013; Excel file "R2013-11 Package Services Worksharing.xlsx," which shows that the DNDC dropship discount and unit avoided costs were 14.1 cents for both BPM Flats and BPM Parcels.

Parcels DNDC dropship discounts. *Id.* at 36. It believes that the above-100 percent passthroughs can be best explained by the lag between the most recent price adjustments and the fiscal year cost avoidance calculations. *Id.*

Public Representative Comments

The Public Representative recognizes the ECSI exemption for the Media Mail/Library Mail product, but is skeptical of the Postal Service's ability to reduce the excessive passthroughs for BPM Flats and BPM Parcels DNDC dropship discounts by bringing unit avoided costs and discounts into better alignment. PR Comments at 44. He notes that there is high year-to-year volatility in avoided costs and observes that the Postal Service's discount flexibility will be more restricted once the exigent rate increases are withdrawn. *Id.*

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 2013, the Commission concludes that four Package Services workshare discounts exceeded unit avoided costs: (1) Media Mail Basic presort; (2) Library Mail Basic presort; (3) BPM Flats DNDC dropship; and (4) BPM Parcels DNDC dropship. All other Package Services workshare discounts did not exceed their respective unit avoided costs, and thus complied with section 3622(e) in FY 2013.*

With respect to the basic presort discounts for Media Mail/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 the 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 finds that the discounts are not in compliance with section 3622(e). Based on the Postal Service's past practices with setting these discounts, and its representation that it intends to align these discounts with avoided costs at the time of the next general market dominant price adjustment, the Commission finds that no further remedial action is required.

Table II-8
Media Mail/Library Mail
Workshare Discounts and Benchmarks

FY2013

Type of Worksharing (Benchmark)	Year-End Discount (cents)	Unit Cost Avoidance (cents)	Passthrough[1]
Media Mail			
Presorting (cents/piece)			
Basic (Single-Piece)	47.00	30.00	156.7%
5-Digit (Basic)	39.00	63.00	61.9%
Library Mail			
Presorting (cents/piece)			
Basic (Single-Piece)	44.00	30.00	146.7%
5-Digit (Basic)	37.00	63.00	58.7%

Source: PRC-ACR2013-LR-4.

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

Table II-9
Bound Printed Matter Flats
Workshare Discounts and Benchmarks

Type of Worksharing (Benchmark)	FY 2013 Year-End Discount (cents)	Unit Cost Avoidance (cents)	Passthrough[3]
Presorting (cents/piece)[1]			
Basic Flats (Single-Piece Flats)	34.4	*See* Note[1]	N/A
Carrier Route Flats (Basic Flats)	9.9	14.5	68.3%
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
Zone 4	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	3.0	*See* Note [2]	N/A
(Single-Piece Non-automation Flats)			
Basic Automation Flats	3.0	*See* Note [2]	N/A
(Basic Non-automation Flats)			
Carrier Route Automation Flats	3.0	*See* Note [2]	N/A
(Carrier Route Non-automation Flats)			
Dropship (cents/piece)			
Basic, Carrier Route DNDC Flats	17.0	14.0	121.4%
(Basic Origin Flats)			
Basic, Carrier Route DSCF Flats	61.5	63.2	97.3%
(Basic Origin Flats)			
Basic, Carrier Route DDU Flats	76.2	79.3	96.1%
(Basic Origin Flats)			

Source: PRC-ACR2013-LR-4.

[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.

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

Table II-10
Bound Printed Matter Parcels
Workshare Discounts and Benchmarks

	FY 2013		
Type of Worksharing	Year-End Discount (cents)	Unit Cost Avoidance (cents)	Passthrough[2]
Presorting (cents/piece)[1]			
Basic Parcels (Single-Piece Parcels)	64.0	*See* Note[1]	N/A
Carrier Route Parcels (Basic Parcels)	9.8	14.5	67.6%
Presorting (cents/pound)			
Basic, Carrier Route Parcels (Single-Piece Parcels)			
Zones 1&2	5.9	*See* Note [1]	N/A
Zone 3	6.6	*See* Note [1]	N/A
Zone 4	6.3	*See* Note [1]	N/A
Zone 5	5.7	*See* Note [1]	N/A
Zone 6	6.4	*See* Note [1]	N/A
Zone 7	4.6	*See* Note [1]	N/A
Zone 8	4.6	*See* Note [1]	N/A
Dropship (cents/piece)			
Basic, Carrier Route DNDC Parcels	17.0	14.0	121.4%
(Basic Origin Parcels)			
Basic, Carrier Route DSCF Parcels	61.6	63.2	97.5%
(Basic Origin Parcels)			
Basic, Carrier Route DDU Parcels	76.5	79.3	96.5%
(Basic Origin Parcels)			

Source: PRC-ACR2013-LR-4.

[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.

PREFERRED RATE REQUIREMENTS

Section 3626 of title 39, United States Code, identifies preferred rate requirements applicable to Periodicals, Standard Mail, and Package Services prices.

Periodicals is a preferred class of mail and receives several statutory discounts identified in 39 U.S.C. 3626, such as a five percent discount for nonprofit and classroom publications. In Docket No. R2013-1, the Commission determined that Periodicals prices were set consistent with statutory preferences for mail in the Periodicals class.[25]

39 U.S.C. 3626(a)(6) requires nonprofit prices in Standard Mail to be set in relation to their commercial counterparts regardless of nonprofits' independent costs. In Docket No. R2013-1, nonprofit prices were set to yield per-piece average revenues that were 60 percent of commercial per-piece average revenues at the class level. Order No. 1541 at 49. The Commission calculates that in FY 2013, the actual per-piece revenue from Standard Mail nonprofit pieces was 59.7 percent of Standard Mail commercial per-piece revenue.

One preferred mail requirement applies to Media Mail/Library Mail, a product in Package Services. 39 U.S.C. 3626(a)(7) requires Library Mail prices to be set at 95 percent of Media Mail prices. In Docket No. R2013-1, the Commission determined that Library Mail prices were set at 95 percent of Media Mail prices. *Id.*

The Commission finds that in FY 2013, prices were in compliance with all the preferred rate requirements identified in 39 U.S.C. 3626.

[25] Docket No. R2013-1, Order on Price Adjustments for Market Dominant Products and Related Mail Classification Changes, November 16, 2012, at 65 (Order No. 1541).

CHAPTER 3

MARKET DOMINANT PRODUCTS: OTHER RATE AND FEE COMPLIANCE ISSUES

INTRODUCTION

Commenters raise other rate and fee compliance issues, most of which relate to the objectives and factors established by 39 U.S.C. 3622 and the policies of title 39, United States Code. These issues include noncompensatory products, negotiated service agreements (NSAs), and pricing issues related to perceived cost coverage disparities. The Commission has also identified some additional cost coverage issues not raised by the commenters.

This chapter begins with an analysis of noncompensatory products, organized by class. It also includes a discussion of Standard Flats (an area of concern to several commenters), issues relating to NSAs, and other pricing issues.

NONCOMPENSATORY PRODUCTS

First-Class Mail Parcels

Following the transfer of commercial First-Class Mail Parcels to the competitive product list in FY 2012, the cost coverage for First-Class Mail Parcels fell to 98.5 percent. FY 2012 ACD at 17. The Commission urged the Postal Service to improve cost coverage through cost reductions and rate adjustments. *Id.* In FY 2013, despite an above-average five percent price increase in January 2013, the attributable costs of First-Class Mail Parcels exceeded revenues by $3 million, resulting in a cost coverage of 99.5 percent. *Id.;* PRC-ACR2013-LR1. On January 26, 2014, the Postal Service increased prices for First-Class Mail Parcels by approximately 11.0 percent.[1] The Postal Service anticipates that the cost coverage for First-Class Mail Parcels as a result of this price increase will be above 100 percent. FY 2013 ACR at 11. The Commission commends the Postal Service for taking steps to increase the cost coverage for First-Class Mail Parcels consistent with the FY 2012 ACD. The Commission shares the Postal Service's expectation that the January 26, 2014 price increase will result in a cost coverage of more than 100 percent.

[1] *See* Order No. 1890 at 38; Docket No. R2013-10, Library Reference PRC-LR-R2013-10/1, November 21, 2013; Docket No. R2013-11, Order Granting Exigent Increase, December 24, 2013, at 193 (Order No. 1926).

Periodicals

Periodicals commenters address whether Periodicals prices were in compliance with title 39 in FY 2013.

In FY 2013, the cost coverage for Periodicals increased for the first time since FY 2008. Periodicals revenue covered 76.1 percent of the $2.2 billion in attributable costs incurred by the class in FY 2013. This resulted in a negative contribution to institutional costs of $521 million. Table III-1 summarizes the financial results for Periodicals since the enactment of the PAEA.

Table III-1
Periodicals Cost Coverage FY 2007—FY 2013

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)
2013	6,359	$1,658	$2,179	76.10%	$(521)
					$(3,938)

Source: PRC-ACR2013-LR-3.

Since the enactment of the PAEA, the cost coverage for Periodicals has declined from 84.0 percent to 76.1 percent. Table III-2 details the unit cost, revenue, and contribution for Periodicals over the same timeframe.

Table III-2
Periodicals Unit Cost, Revenue, and Contribution FY 2007—FY 2013

	Cost/Piece	Revenue/Piece	Contribution/Piece
2007	$0.2997	$0.2488	$(0.0509)
2008	$0.3175	$0.2667	$(0.0508)
2009	$0.3370	$0.2563	$(0.0807)
2010	$0.3425	$0.2585	$(0.0841)
2011	$0.3434	$0.2573	$(0.0860)
2012	$0.3562	$0.2568	$(0.0994)
2013	$0.3427	$0.2608	$(0.0819)

Source: PRC-ACR2013-LR-3.

In FY 2013, the average contribution per piece for Periodicals improved to negative 8.1 cents per piece. Reversing a trend since FY 2006, the cost per piece for Periodicals decreased in FY 2013 to roughly the same level as FY 2010. Further, revenue per piece for Periodicals increased by 0.4 cents in FY 2013.

The Postal Service summarizes the Periodicals cost coverage issue as follows:

> The Postal Service shares the Commission's concern about Periodicals cost coverage, and, as stated in the *Periodicals Mail Study*, "the Postal Service and the Commission will continue to work together to identify and address challenges related to Periodicals." That Study outlined the continuing steps that the Postal Service is taking to reduce costs. The improved cost coverage shows that savings from those steps are now starting to accrue.
>
> More generally, while the Postal Service will continue to pursue whatever efficiency enhancements are possible, it is extremely doubtful, in the context of price increases limited to the CPI cap, that the Periodicals class can achieve 100 percent cost coverage.[2]

Valpak notes that the Postal Service has lost $3.44 billion from Periodicals since FY 2008. Valpak Comments at 46. Valpak discusses underwater products and flat-shaped mail generally, but does not discuss Periodicals compliance issues specifically. Valpak states that "[t]he Postal Service has offered false promises about declining flats costs for many years, which the Commission has accepted, but it would be irresponsible if one were to repeat that mistake again." *Id.* at 63. Valpak contends that the FY 2013 prices violated section 3622(c)(2), section 3622(c)(7), section 3622(c)(12), section 101(d), section 3622(b)(1), section 3622(b)(2), section 3622(b)(5), section 403(c), and section 404(b), but does not propose a remedy for these violations. *Id.* at 50-51.

The Public Representative notes the improvement in Periodicals cost coverage in FY 2013, and states that while "a one year improvement in the financial results does not yet provide a solid ground for positive conclusions, it gives some hope." PR Comments at 31. The Public Representative requests the Commission to "direct the Postal Service to continue implementing cost savings and productivity improvement measures." *Id.* at 32.

Magazine Publishers of America, Inc. (MPA) and the Alliance of Nonprofit Mailers (ANM) urge the Commission to reject Valpak's argument that Periodicals prices were out of compliance with title 39 in FY 2013. MPA & ANM Reply Comments at 2, 17. MPA and ANM note that the Public Representative's request that the Commission direct the Postal Service to continue implementing cost savings and productivity improvement measures has "considerable merit." *Id.* at 2. MPA and ANM state that the Commission needs to "confront directly the elephant in the living room of Periodicals mail pricing: the Postal Service's failure to rein in the out-of-control costs of Periodicals

[2] FY 2013 ACR at 32-33.

Mail despite large investments in automation equipment by the Postal Service, and large increases in worksharing by periodical publishers and their mail service providers." *Id.*

Regarding Valpak's argument that Periodicals prices were out of compliance with title 39, MPA and ANM address each of Valpak's arguments concerning sections 3622(c), 3622(b), 403(c), 101(d), and 404(b). *Id.* at 3-10.

Despite the failure of Periodicals to cover costs since FY 1996, the Commission does not find the rates and fees for the Periodicals class to be out of compliance for FY 2013.

In the FY 2012 ACD, the Commission found that "the Postal Service needs to take further action to reverse Periodicals negative net revenue trend." FY 2012 ACD at 18. The Commission directed the Postal Service to "leverage its pricing flexibility to improve Periodicals bundle and container pricing to incent more efficient mailer preparation and increase contribution from Periodicals." *Id.* at 101. The Commission also directed the Postal Service to "pursue the considerable opportunities identified in FY 2012 to reduce the costs of handling Flats." *Id.* at 97.

Regarding the Commission's direction to leverage its pricing flexibility, the Postal Service continued its strategy, initiated in Docket No. R2009-2, of across-the-board price increases for the rate elements in Periodicals in Dockets No. R2013-10 and R2013-11. In Docket No. R2013-11, the Commission approved the implementation of the exigent surcharge. The Postal Service estimated that the cost coverage of Periodicals would increase to 81 percent for FY 2014. The FY 2013 increase in unit revenue was driven by an increase in pounds per piece. As discussed in Chapter 2, *supra*, the Commission is increasingly concerned that the Postal Service's Periodicals pricing strategy is leading to inefficient mailer preparation. The inefficient pricing signals being sent by the Postal Service's prices prevent the Postal Service from maximizing contribution from Periodicals. Further, the inefficient price signals are increasingly creating winners and losers within the Periodicals class. *See* Chapter 2, *supra*.

Following the Commission's direction to reduce costs, in FY 2013, the Postal Service continued to implement operational strategies to reduce the cost of flats, as detailed in its response to CHIR No. 2, question 1.[3] The Postal Service described the new and ongoing operational initiatives it took in FY 2013 to make its processing of flats more efficient. However, the Postal Service did not relate its success in reducing Periodicals unit costs to the operational initiatives it implemented, noting that no "analysis has been performed to isolate the cost savings from these initiatives, assuming that such analyses are even possible with available data." *Id.* The Commission is concerned that the Postal Service is not measuring the success of the operational initiatives it has implemented to reduce the costs of Flats.

[3] Response to CHIR No. 2, questions 1-11.

In the *Periodicals Mail Study*, the Commission and the Postal Service worked together to generate an enhanced understanding of the challenges facing the Periodicals class. In the study, the Postal Service detailed projects that would improve Periodicals cost coverage. For FY 2013, the Postal Service was unable to report on the success of these initiatives. The Commission expects the Postal Service to continue the work of the *Periodicals Mail Study* and update its analysis for implementation results. The Commission is willing and able to work with the Postal Service in this endeavor. Further, in the *Periodicals Mail Study*, the Postal Service discussed pricing strategies it may choose to pursue in the future. The Commission expects the Postal Service to detail its progress, if any, in pursuing its Periodicals pricing strategies.

In the FY 2014 ACR, the Postal Service must provide a detailed analysis of the progress made in improving Periodicals cost coverage. This report shall include:

- *The impact of leveraging its pricing flexibility to improve the efficiency of Periodicals pricing;*
- *The impact of the implementation of operational strategies outlined in Chapter 7 of the Periodicals Mail Study, specifically, how actual savings compare with the $146 million estimated in Table 9; and*
- *The progress in implementing pricing strategies outlined in Chapter 7 of the Periodicals Mail Study.*

Standard Mail Flats

Prior to FY 2012, the cost coverage for Standard Mail Flats had decreased every fiscal year since 2008. In FY 2012, cost coverage for Standard Mail Flats increased by 1.4 percentage points over FY 2011. In FY 2013, cost coverage for Standard Mail Flats increased 4.2 percentage points, from 80.9 in FY 2012 to 85.1 percent in 2013.

The improvement in cost coverage was driven by a unit revenue increase of 0.7 cents, and a decrease in unit attributable cost of 1.3 cents. Although total contribution from Standard Mail Flats was a negative $376 million, this was an improvement of $152 million over FY 2012.

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, and 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. FY 2010 ACD at 106. In addition, the Postal Service was directed to provide in each of its subsequent ACRs 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 this subsidy. *Id.* at 107. Consistent with the Commission's directive, in subsequent market dominant price adjustments, the Postal Service was required to report the following: (1) an explanation of how the proposed prices will move the Flats cost coverage toward 100 percent; and (2) a statement estimating the effect that the proposed prices will have in reducing the subsidy of the Flats product. *Id.*

The Postal Service appealed to the United States Court of Appeals for the District of Columbia Circuit the Commission's FY 2010 ACD findings and directive. On April 17, 2012, the United States Court of Appeals for the District of Columbia Circuit issued an opinion in *USPS v. Postal Regulatory Comm'n*, 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 1109. 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.[4]

The Commission identified the following specific factors which, in the case of Standard Mail Flats, triggered section 101(d)'s protections: (1) a significant and growing cost coverage shortfall; (2) the duration of the shortfall over a significant period; (3) evidence the shortfall is likely to increase further, and a significant adverse impact on users of other products; (4) failure of the Postal Service to address the shortfall; and (5) 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. Order No. 1427 at 10. 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 9. 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, the Commission found in its FY 2011 ACD 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. FY 2011 ACD at 118-19. 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, 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.[5] 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. *Id.* at 3.

[4] Docket No. ACR2010-R, Order on Remand, August 9, 2012, at 4 (Order No. 1427).

[5] Docket No. ACR2010-R, Notice and Order Confirming Termination of Stay, September 21, 2012.

In its FY 2012 ACD, the Commission found that "the Postal Service has begun to make progress towards addressing the issues raised by the Commission in the FY 2010 ACD…[and]…[t]he approach advocated by the Postal Service does not require changes to the Commission's FY 2010 ACD directive." FY 2012 ACD at 116.

Postal Service Response to ACD Directive

In its FY 2013 ACR, the Postal Service provides a two-year schedule of above-Consumer Price Index (CPI) price increases for the Standard Mail Flats product. FY 2013 ACR at 20. The Postal Service plans to increase Standard Mail Flats prices by CPI multiplied by 1.05 in 2015 and 2016. It reiterates its argument in Docket No. R2013-10 that a two-year outlook for scheduling above-price increases for Standard Mail Flats is appropriate because the Commission's review under 39 U.S.C. 3622(d)(3) of the system for regulating rates and classes for market dominant products is slated to begin in FY 2017.[6]

In its FY 2013 ACR, the Postal Service did not provide the information required by the Commission's FY 2010 ACD directive, e.g., a description of operational changes designed to reduce Flats costs, a description of all costing methodology or measurement improvements made in the previous fiscal year, and an estimated timeline for phasing out this subsidy. FY 2010 ACD at 107. However, in its Response to CHIR No. 2, question 1, the Postal Service describes several new and ongoing steps that it took during FY 2013 to make its processing of Standard Mail Flats more efficient: (1) FSS Scorecard; (2) Move Mail Up the Ladder;[7] (3) Bundle Operation;[8] (4) Service Performance Diagnostics Tool; (5) FSS Daily Sort Program (Batting) Order Optimization Tool;[9] (6) FSS Tiger Teams; (7) Lean Mail Processing (LMP); and (8) Cost Per Work Hour.[10]

The Postal Service does not provide the financial effect of the operational changes identified above. In its Response to CHIR No. 2, question 1, it states, "[n]o analysis has been performed to isolate the cost savings resulting from these initiatives, assuming that such analyses are even possible with available data." *Id.*

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[6] *See* Docket No. R2013-10, Response of the United States Postal Service to Chairman's Information Request No. 3, Questions 1-2 and 6-7, October 24, 2013, question 6 (Docket No. R2013-10 Response to CHIR No. 3). *See also* FY 2013 ACR at 19-20.

[7] In FY 2013, the Postal Service continued its efforts to move flat mail from manual flats processing operations to processing on automated equipment. As part of its network rationalization effort, the Postal Service consolidated 143 processing plants, which reduced the number of facilities with manual processing. While this should have decreased manual processing, the Postal Service noted that the percentage of manually processed flats increased from 8.5 percent to 9.4 percent in FY 2013. It attributed this increase to initial plant consolidation activities, which mostly occurred during the fourth quarter of FY 2013. It expects to see the percentage of manual processing to decline in FY 2014 as the benefits of these consolidations are realized. Response to CHIR No. 2, question 1.

[8] The Postal Service explains that "Bundle Operation" is the conversion of Small Parcel Bundle Sorter (SPBS) units to Automated Parcel and Bundle Sorter (APBS) units. This conversion, which was completed in FY 2013, has reduced operating costs and improved operational efficiency by replacing aging equipment with newer technology and resulted in improved throughput per hour performance. *Id.*

[9] The Postal Service explains that this tool produces the "optimum" sort program run order for FSS machines based on dynamic flat mail volumes and expected throughput per hour performance. *Id.*

[10] For a discussion of each of these initiatives, refer to the Postal Service's Response to CHIR No. 2, question 1.

In its Response to CHIR No. 2, question 1, the Postal Service identifies three costing methodology changes that affected Standard Mail Flats costs in FY 2013, all of which were part of Docket No. RM2013-6: (1) Proposal One; (2) Proposal Two; and (3) Proposal Three.[11] These three methodology changes added $0.7 million in attributable cost to Standard Mail Flats.

Additionally, the Postal Service provides the historical and current fiscal year subsidy of the Standard Mail Flats product. However, it does not provide a timeline for phasing out the subsidy and reiterates, as initially noted in its Response to CHIR No. 1, question 2(c) in the FY 2012 ACR,[12] that it is difficult to predict when the shortfall for Standard Mail Flats will be phased out. *See also* Response to CHIR No. 2, question 1(c).

It also indicates it is unlikely that the shortfall will be eliminated by the end of 2016 (when the Commission commences its review of the rate system) and states that "[t]he prospects for eliminating the shortfall thereafter will depend not only on pricing and cost saving initiatives, but also on any changes made to applicable regulations by the Commission." *Id.* The Postal Service also notes that "over the past two fiscal years the Postal Service has reduced the Standard Mail Flats shortfall by $272 million…[and]…predicts that similar progress will be made in the upcoming year." *Id.*

Comments on Standard Mail Flats Product

The Commission received comments from ACMA, the PR, and Valpak related to the Standard Mail Flats product. The comments generally address four areas: (1) relationship of Standard Mail Flats to other Standard Mail products; (2) intra-class cross-subsidy; and (3) recommendations for future costing models; and (4) cost coverage and compliance.

Relationship of Standard Mail Flats to Other Standard Mail Products

ACMA argues that Standard Mail Flats should not be evaluated and priced in isolation because this product is "composed of mail that, due to volume limitations, cannot be presorted more finely than a 5-digit area,...[and]…simply cannot reach the 10-piece threshold for Carrier Route." ACMA Comments at 3-4. ACMA maintains that "the rates for Standard Flats are part of a schedule of rates…[that]…includes Standard Flats, Carrier Route, and High-Density, whose differences are not based on meaningful criteria,…have been eroded by DPS processing, and are now being eroded further by FSS processing." *Id.* at 4. ACMA believes "the Postal Service should be allowed latitude in selecting these differences." *Id.*

[11] On February 4, 2014, the Commission issued Order No. 1983 approving Proposals One through Five in Docket No. RM2013-6. *See* Docket No. RM2013-6, Order No. 1983, Order on Analytical Principles Used in Periodic Reporting (Proposals One Through Five), February 4, 2014. Proposal One would implement a simpler method for calculating the Alaska Air Adjustment Factor within Cost Segment 14 (Purchased Transportation) using postal operational data from the Transportation Cost System (TRACS) instead of U.S. Department of Transportation data. Proposal Two would establish a single set of distribution factors to assign relevant costs from the Non-Preferential Alaska Air, Preferential Alaska Air, Hawaii Air, and Air Taxi cost pools to products using current postal operational data from the TRACS, which would also remedy an inaccuracy in the distribution of Air Taxi costs. Proposal Three would create a set of proxy distribution factors, updated quarterly, to assign relevant costs from Cost Segment 14 Highway Plant Load and Rail Plant Load cost pools to products as an alternative to the current distribution factors, which are derived from special studies.

[12] Docket No. ACR2012, 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 2(c).

The Public Representative contends that if, as ACMA asserts, Standard Flats is a residual category that cannot be separated from Standard Mail Carrier Route, and Standard Mail High Density and Saturation Flats, then it follows that Standard Flats should not be considered a separate product. PR Reply Comments at 7. If this is the case, he suggests that ACMA petition to open a rulemaking so that the Commission can determine whether the MCS should be modified accordingly. *Id.* at 7-8.

Valpak contends that almost all of Standard Mail is advertising mail that adds value regardless of the type of mailing method used. Valpak Reply Comments at 2. In addition, every class of mail has some form of "residual" mail that the Postal Service accepts and processes at a higher cost. *Id.* at 7. However, Valpak does not believe that this residual mail is a separate category with its own rate. *Id.*

Intra-Class Cross-Subsidy

ACMA argues that to determine if a product is being cross-subsidized, one needs to conduct a burden test which analyzes the effects of withdrawing products that are complements or substitutes for one another. ACMA Initial Comments at 7, n.8. In conducting such a test, ACMA asks a series of questions pertaining to the removal of various products such as Standard Mail Flats. It concludes that removal of Standard Flats would leave in place Standard Mail Carrier Route and Standard Mail High-Density, which it states are "nothing more than highly prepared forms of Standard Flats." *Id.* at 8. Given this conclusion, ACMA asserts "[t]here can be disagreement about how the Postal Service selects the rate elements for the various categories of Commercial Flats, and there can be opinions that the cost coverage for this grouping should be higher, but there is no subsidy that needs to be fixed." *Id.* at 9.

Valpak argues that the existing cross-subsidies within Standard Mail demonstrate a deliberate misuse of the Postal Service's pricing flexibility. Valpak Comments at 33. It further contends that the Commission "has allowed 'pricing flexibility' to override title 39 so that under no circumstances can the playing field be considered level, nor can the law be seen to protect mailers from implicit stamp taxes and cross-subsidies to those other mailers which the Postal Service chooses to favor." *Id.*

The Public Representative responds to Valpak's assertion that Standard Flats are subsidized by other Standard Mail products. PR Reply Comments at 6-7. He states that because Standard Flats make no contribution toward institutional costs, there is no question that this product is being subsidized by other postal products. However, he states that one cannot conclude that the subsidy is only coming from other Standard Mail products. *Id.* at 6. The Public Representative points out that because "the Commission does not have approved incremental or stand-alone cost models by product and groups of products, it is not possible to conclude that Standard Flats, or any product with a cost coverage less than 100 percent is being subsidized." *Id.* at 7. However, the Public Representative does support Valpak's basic point that products such as Standard Mail Flats that are not contributing to institutional costs are not satisfying section 3622(c)(2). He also agrees "that other mail products with revenues greater than their attributable costs are bearing an inequitable share of institutional costs." *Id.*

Recommendations for Future Costing Models

Valpak offers its revised Standard Mail contribution model[13] to demonstrate the inadequacy of the Postal Service's rationale that raising rates for Standard Mail Flats may cause it to lose revenue. Valpak Comments at 18-42, Appendix. The revised model allows users of the model to adjust the assumed elasticity of each product individually and conduct sensitivity analyses with different elasticities. Independent secular trends may be introduced to distinguish between trend-induced and elasticity-induced changes in volume. Additionally, the model allows unit costs to be adjusted to distinguish between nominal and real price adjustments. *Id.* at 24. The model is no longer a single-period model. It has been expanded to include an additional period and shows how to increase contribution systematically, up to the maximum available under the cap. *Id.* at 40. By using its revised model, Valpak contends that the Postal Service could increase contribution, up to the maximum available under the price cap, by bringing the price of Standard Mail Flats up so as to cover its costs as soon as possible. *Id.* at 42.

ACMA states that Valpak's subsidy test—which asks whether the profits of the Postal Service would increase if a product were withdrawn—is "irrelevant" because it improperly isolates Standard Flats for removal, instead of taking the continuum[14] approach into account. ACMA Reply Comments at 3-4. It also criticizes Valpak's model because it includes nonprofit categories in the withdrawal. *Id.* at 3. It states that for purposes of the test, if Valpak treated the nonprofits as though they paid commercial rates, and then estimated the effects of withdrawing the entire group consisting of Standard Flats, Carrier Route, and High-Density, the cost coverage would be above 100 percent and negative effects on Postal Service profits would be even greater, especially if interdependencies are considered. *Id.* at 4. ACMA argues that the volume of Standard Mail Flats has declined significantly while the portion of nonprofit has increased. It argues that "the advent of the FSS has blurred the separability of Standard Flats, important questions concerning the validity of the costing results have been raised, and the nature of the continuum of rates used by Flats mailers has been clarified." *Id.* at 5.

The Postal Service argues that "in its current state, Valpak's model remains seriously flawed." Postal Service Reply Comments at 4. More specifically, the Postal Service contends that Valpak's model only presents a 2-year time horizon, which is not enough for long-run effects to materialize. It assumes no secular volume declines and that the optimum contribution can be obtained by a sequence of static short-run solutions. It also explores only a single price path and does not consider other price paths that may achieve greater contribution in the long run. *Id.* at 5.

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[13] Docket No. ACR2012, Valpak Direct Marketing Systems, Inc. and Valpak Dealers' Association, Inc. Initial Comments on the United States Postal Service FY 2012 Annual Compliance Report, February 1, 2013, at 80-107, Appendix A. *See also* Docket No. R2013-11, Initial Comments of Valpak Direct Marketing Systems, Inc., and Valpak Dealers' Association, Inc., November 26, 2013, at 99-106, Appendix.

[14] According to ACMA, excluding the commercial categories of High Density Plus and Saturation, the following categories form a continuum: (1) High Density, (2) Carrier Route, (3) 5-Digit preparation, (4) 3-Digit preparation, (5) ADC preparation, and (6) Mixed ADC preparation. ACMA Comments at 2 n.2.

The Postal Service also asserts that its "focus has always been on the bottom line. Rather, the reference to 'revenue yield' in witness Taufique's response was included: (1) because revenue yield is an important component of profitability; and (2) because revenue yield is constrained (on a before-rates basis) by the price cap." *Id.* at 5. The Postal Service contends that it "continues to make progress toward moving Standard Mail Flats toward 100 percent cost coverage and believes that such progress will continue with the implementation of the agreed upon schedule of price increases and future cost savings." *Id.* It "believes that the Commission's current approach best balances the interests of all parties....[and] the Commission should decline to implement any additional orders with regard to Standard Mail Flats pricing." *Id.*

Cost Coverage and Compliance

Although ACMA has argued in the past that the increase in unit costs is primarily due to costs of excess capacity being attributed to Standard Flats, it notes that the cost coverage indicates the downsizing of the Postal Service's operations and reducing its excess capacity is working, and ACMA is optimistic that the Postal Service's ongoing efforts to right size its network will continue to work. *See* ACMA Comments at 13. As such, ACMA recommends that the Commission find that the rates for Standard Flats are satisfactory and not in violation of title 39. *Id.*

The Public Representative agrees that the Postal Service is on the right track in its measures to improve cost coverage. He points out that the Postal Service has improved its cost coverage for Standard Mail Flats and recognizes that the Postal Service continues to undertake multiple operational changes in order to reduce Standard Mail Flats costs, as directed by the FY 2010 ACD. He notes that the Commission in the FY 2012 ACD acknowledged the Postal Service's progress towards addressing the issues raised in the FY 2010 ACD directive and that the Postal Service should continue to follow such directive. PR Comments at 27-28. He believes that "[c]ontinued improvement in cost coverage for Standard Flats proves the effectiveness of a 'special remedy,' i.e. above CPI price increases for Standard Mail Flats." *Id.* at 29.

However, the Public Representative notes that the Postal Service did not adopt the Commission's FY 2012 ACD recommendation to "derive elasticity estimates to provide for a more realistic assessment of the impact of price changes on contribution." *Id.* at 30. Given that the Postal Service still estimates own price elasticity for all Standard Mail without any differentiation by product and that the elasticity for Standard Mail Flats is thus unknown, the Public Representative believes that "[t]he Postal Service's failure to provide elasticities for products is a strong disadvantage." *Id.* He reiterates his recommendation, initially made in his FY 2012 ACR Reply Comments, that the Postal Service utilize a demand-based pricing policy when setting prices for Standard Mail products. *Id.* Using this pricing policy should "ensure the greater product contribution to institutional costs, and a positive effect of such rate increases on the general public and other mail users in accordance with 39 U.S.C. § 3622(c)(3)." *Id.*

Valpak disagrees with the notion that the Standard Flats product is moving in the right direction. It contends that the "deliberate underpricing of Standard Flats sends erroneous price signals, encouraging mailers to enter mail that the Postal Service cannot handle in an economically efficient manner[.]" Valpak Comments at 5. It states that in FY 2013, the "inequitable and unlawful Standard

Mail pricing has gotten worse, not better." *Id.* It opines that "[n]o exigent rate case would have been necessary if the Postal Service had properly used its pricing flexibility." *Id.* at 8. It observes that since enactment of the PAEA, the Postal Service has accumulated losses on underwater products, which includes Standard Mail Flats, in the amount of $8.6 billion, of which approximately $1.0 billion was added in FY 2013. *Id.*

Valpak maintains that "the pricing aspects of the Commission's remedial order in the FY 2010 ACD have been disregarded and frustrated by the Postal Service." *Id.* at 6. It contests the Postal Service's reasons that, under a price cap regime, compliance with the Commission's FY 2010 ACD directive would cause it to lose money.

Valpak argues that the pricing of the Standard Mail 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 Standard Mail High Density/Saturation Letters, in violation of 39 U.S.C. 403(c). Valpak Comments at 43-51, 62. It contends that the Postal Service's failure to properly price underwater products resulted in an exigent price adjustment that violated 39 U.S.C. 3622(b)(2), predictability and stability in rates, at the expense of profitable products such as Standard Mail High Density and Saturation Letters and Standard Mail High Density and Saturation Flats. *Id.* at 48-51.

As for the FY 2010 ACD directive, Valpak argues that the Postal Service has "alternately challenged, defied, ignored, and minimally complied with the Commission remedial order to adjust prices for Standard Flats[.]" *Id.* at 52. It asserts that Standard Mail prices fail to apportion the costs of postal operations to all Standard Mail users on a fair and equitable basis. *Id.* at 60-62. Valpak believes that "[n]ow is the time for the Commission to use its full range of remedial powers to ensure compliance with its own order." *Id.* at 7. It urges the Commission to find that the Standard Mail Flats product remains out of compliance and in addition to the FY 2010 ACD directive; it should require higher Standard Mail Flats rates that cannot be circumvented. *Id.* at 60. In addition, Valpak urges the Commission to issue "a new remedial order…[that] would rescind its recent approval of increased prices [Docket Nos. R2013-10 and R2013-11] for Standard Mail approved previously, and order the Postal Service to establish lawful rates for all Standard Mail products as soon as possible." Valpak Reply Comments at 46-47.

In response, ACMA discounts Valpak's argument that the existence of underwater products triggered the Postal Service's exigency request. ACMA Reply Comments at 2. ACMA believes that Standard Flats should be viewed as part of a continuum of categories used by Commercial Flats mailers, which encompasses Standard Flats, Carrier Route, and High Density. *Id.* at 4. According to ACMA, reported coverage has improved and there are sound reasons to expect further improvement. It urges the Commission to reconsider the FY 2010 ACD directive. *Id.* at 5.

The Public Representative also disagrees with Valpak's conclusion that the Postal Service is not in compliance with the FY 2010 ACD directive. He states that as the Commission explained in the FY 2012 ACD, losses alone do not necessarily require a finding of non-compliance. He believes that since the "…Commission concluded in the 2012 ACD that no further remedial action was necessary and in FY 2013 contribution continued to improve and the Postal Service's actions continue to improve contribution, it must be concluded that the remedial directives in the 2010 ACD do not need revision." PR Reply Comments at 6.

The Postal Service takes issue with Valpak's conclusion that it has not complied with the FY 2010 ACD directive. It understands:

> why a mailer of High Density/Saturation Letters would focus its attention on the cost coverage gap between these products (Standard Mail Flats and Standard Mail High Density and Saturation Letters), [but argues that] this argument is simply not germane to whether the Postal Service has complied with Commission's orders, particularly its order in the Annual Compliance Determination for Fiscal Year 2010 ('2010 ACD Order'). In this regard, it is noteworthy that Valpak's comments virtually ignore the over five percentage point increase in Flats cost coverage achieved since the FY 2011 ACD.

Postal Service Reply Comments at 3. Furthermore:

> [a]s evidenced by: 1) the implementation of two above average price increases for Flats in Docket Nos. R2013-1[15] and R2013-10;[16] 2) the recent improvement in Flats' cost coverage; and 3) the Postal Service's commitment to implementing the schedule of above-average price increases approved by the Commission in the FY 2012 ACD, the Postal Service believes that it is in full compliance with the Commission's orders and directives.

Commission Analysis

Although a significant cost coverage shortfall still exists in FY 2013, it is not growing. The combination of above-average price increases for Standard Mail Flats in Docket No. R2013-1,[17] a decrease of 2.8 percent in unit cost per piece from 46.5 cents in FY 2012 to 45.2 cents in FY 2013, and a decrease of 6.2 percent in volume from 5.94 billion pieces in FY 2012 to 5.6 billion pieces in FY 2013 resulted in a loss of $376 million in FY 2013. This is an improvement of $152 million over FY 2012, and is the second fiscal year that Standard Mail Flats has improved its contribution and reduced its cost coverage shortfall.

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[15] Docket No. R2013-1, Order on Standard Mail Rate Adjustments and Related Mail Classification Changes, December 11, 2012 (Order No. 1573).

[16] Docket No. R2013-10, Order No. 1902, Order Approving Amendments to Notice of Market Dominant Price Adjustments, December 11, 2013. In its Reply Comments, the Postal Service cited Order No. 1904, but Order No. 1902 actually addressed the above-average price increases referenced in Docket No. R2013-10.

[17] *See* Order No. 1573.

In FY 2013, the Postal Service has continued to undertake various operational changes to make Standard Flats processing more efficient. In conformance with the FY 2010 ACD directive, the Postal Service presents a schedule of future Standard Flats price increases of at least CPI x 1.05 in 2015 and 2016.[18] These measures may prevent cost increases from outpacing price increases, which in turn, may decrease the shortfall.

The unit contribution gap between Standard Mail Letters and Standard Mail Flats, and between Standard Mail Carrier Route and Standard Mail Flats, has continued to decrease in FY 2013. The gap between Standard Mail Letters and Standard Mail Flats decreased from 17.5 cents in FY 2012 to 16.2 cents in FY 2013. Similarly, the gap between Standard Mail Carrier Route and Standard Mail Flats decreased from 14.7 cents in FY 2012 to 13.1 cents in FY 2013. In addition, the gap between Standard Mail High Density and Saturation Letters and Standard Mail Flats decreased from 16.5 cents in FY 2012 to 14.9 cents in FY 2013, and the gap between Standard Mail Flats and Standard Mail High Density and Saturation Flats and Parcels decreased from 17.9 cents in FY 2012 to 16.4 cents in FY 2013.

In response to the Commission's FY 2010 ACD directive, the Postal Service has taken steps to address the cost coverage shortfall. In FY 2013, the Postal Service made improvements with regard to cost and revenue. Nonetheless, some 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 notes that the Postal Service has taken remedial steps to address the cost coverage shortfall, and as indicated above, the cost coverage gaps are decreasing. If implemented, the schedule of price increases presented by the Postal Service coupled with cost changes below CPI-U would lead to continued improvement.

The Commission finds that progress is being made towards addressing the issues raised by the Commission in the FY 2010 ACD. As a result, no further remedial action is required at this time.

According to the Postal Service, while it has described the new and ongoing steps it has taken during FY 2013 to make its processing of Flats more efficient, "[n]o analysis has been performed to isolate the cost savings resulting from these initiatives, assuming that such analyses are even possible with available data." *See* Response to CHIR No. 2, question 1. 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 establishes similar targets in the form of performance goals in its Annual Performance Plans and Reports under 39 U.S.C. 2803 and 2804.[19]

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[18] FY 2013 ACR at 19-20. The Postal Service states that "[t]he Commission approved the schedule of above average price increases in its ACD for FY 2012." *Id.* at 19, citing the FY 2012 ACD at 115-16. While this observation is correct as to the formula proposed (CPI x 1.05), no temporal limit was suggested or implied by the Commission in its FY 2012 ACD.

[19] *See* 39 U.S.C. 2801(3) (defining "performance goal" as "a target level of performance expressed as a tangible, measurable objective, against which actual achievement shall be compared…").

The Commission remains concerned that the Postal Service has not quantified the cost savings from operational changes designed to reduce Standard Mail Flats costs.[20]

To assist the Commission's review, it recommended in the FY 2012 ACD that "the Postal Service derive elasticity estimates to provide for a more realistic assessment of the impact of price changes on contribution." FY 2012 ACD at 116. The Postal Service indicated that for each quarter in which new data became available, it estimated both aggregate and disaggregated shape-based (letters and non-letters) Standard Mail equations with the additional data. According to the Postal Service, "the disaggregated shaped-based equations have still not yielded results which would suggest that substituting the disaggregated elasticity estimates for the aggregate estimates would generate better forecasts or otherwise improve the assessment of the impact of price changes on contribution." [21]

The Commission appreciates the Postal Service's efforts to derive elasticity estimates as recommended in the FY 2012 ACD. Having these elasticity estimates would provide for a more realistic assessment of the impact of price changes on volume and total contribution. Therefore, the Postal Service should continue its efforts to derive elasticity estimates for Standard Mail products.

Standard Mail Parcels

In FY 2013, the Standard Mail Parcels product again did not produce sufficient revenues to cover its attributable costs. The Standard Mail Parcels product had a 67.9 percent cost coverage, a decline of 17.6 percentage points from FY 2012. The Postal Service notes that "[t]his decline comes on the heels of repeated above average price increases – i.e. 2.864 percent in January 2012 (vs. 2.041 percent class average); 3.081 percent in January 2013 (vs. 2.569 percent class average); and 1.820 percent (based on Docket No. R2013-10) in January 2014 (vs. 1.642 percent class average)." FY 2013 ACR at 18. It indicates that these changes have "left the remaining Standard Mail Parcels product with a significantly higher proportion of nonprofit mailpieces, driving down cost coverage." *Id.* While this latest increase, which was effective on January 26, 2014, is the sixth consecutive increase for Standard Mail Parcels, the Postal Service indicates that it is "committed to improving this product's cost coverage by proposing above average price increases in future price adjustments." *Id.*

In FY 2013, the revenue generated from Standard Mail Parcels was not sufficient to recover the attributable cost of the product. The Public Representative observes that Standard Parcels' attributable cost has decreased. Thus, he concludes that the Postal Service is "on the right track in the measures undertaken to improve cost coverage, including proposed above average price increases in future price adjustments." PR Comments at 27.

Standard Mail Parcels experienced a decline in its cost coverage and significantly increased its negative unit contribution to institutional costs by 32.8 cents from a negative 16.1 cents in FY 2012. However, the

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[20] 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.

[21] Docket No. FY 2013ACR Responses of the United States Postal Service to Questions 1-20 of Chairman's Information Request No. 4, February 6, 2014, question 13 (CHIR No. 4).

loss was reduced by $13.7 million over FY 2012 to a $35.2 million loss in FY 2013. The reduction in losses may be due to a decline of 76.3 percent of volume from FY 2012, as the market dominant commercial Standard Mail Fulfillment Parcels was transferred to the competitive product list.[22] These changes became effective on January 22, 2012.

The Commission finds that the Postal Service's approach to improve the cost coverage for Standard Mail Parcels through above-average price increases in future price adjustments is appropriate.

Single-Piece Parcel Post

In FY 2013, Single-Piece Parcel Post had a cost coverage of 93.1 percent, a 0.9 percentage point increase from FY 2012. Unit contribution increased 12.0 cents per piece from FY 2012 to FY 2013. Despite the increase in unit contribution, this is the seventh consecutive year that Single-Piece Parcel Post did not generate sufficient revenues to cover attributable costs.

Single-Piece Parcel Post was offered for approximately four months in FY 2013. On January 27, 2013, the following three related product list changes occurred: (1) Single-Piece Parcel Post was removed from the market dominant product list; (2) a similar single-piece product, Standard Post, was added to the competitive product list; and (3) the Alaska Bypass Service[23] subcategory of the former Single-Piece Parcel Post was added to the market dominant product list as a Package Services product offering.[24]

Public Representative Comments

The Public Representative notes that Single-Piece Parcel Post did not cover its attributable costs in FY 2013. PR Comments at 32-33. He observes that Single-Piece Parcel Post was eliminated from the market dominant product list in FY 2013. *Id.* at 33.

Commission Analysis

Single-Piece Parcel Post did not cover its attributable costs during the four months that it was in effect in FY 2013, so it made no contribution to institutional costs. Thus, for FY 2013, Single-Piece Parcel Post was inconsistent with section 3622(b)(5) (revenue adequacy), and section 3622(c)(2) (cost coverage). Since Single-Piece Parcel Post was removed from the market dominant product list on January 27, 2013, no remedial action is warranted.

[22] 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, and Docket No. CP2012-2, Order No. 1062, Order Approving Changes in Rates of General Applicability for Competitive Products, December 21, 2011.

[23] Alaska Bypass Service allows shippers to send shrink-wrapped pallets of goods within Alaska from designated "hub points" to designated "bush points." These pallets are flown to remote rural Alaska areas using commercial air carriers. Therefore, Alaska Bypass Service attributable costs are reflected only in intra-Alaska air transportation costs (cost segment 14.1.1). *See* Library Reference USPS-FY13-2, Excel file FY13.Public CS&CRpt.Revised.xls, tab CS14 (revised February 6, 2014).

[24] *See* Docket No. MC2012-13, Order No. 1411, Order Conditionally Granting Request to Transfer Parcel Post to the Competitive Product List, July 20, 2012. In Docket No. CP2013-3, the Commission determined that the Postal Service satisfied the conditions of Order No. 1411. *See* Docket No. CP2013-3, Order No. 1536, Order Approving Changes in Rates of General Applicability for Competitive Products, November 8, 2012, at 16. In that docket, the Commission also approved the Postal Service's request to change the name of the product from Parcel Post to Standard Post. *See also* Docket No. R2013-1, Order No. 1541, Order on Price Adjustments for Market Dominant Products and Related Mail Classification Changes, November 16, 2012, at 69 (adding Alaska Bypass Service to the market dominant product list effective January 27, 2013).

Media Mail/Library Mail

In FY 2013, Media Mail/Library Mail had a cost coverage of 85.0 percent, a 0.3 percentage point decrease compared to FY 2012. Unit contribution decreased 3.8 cents per piece from FY 2012 to FY 2013. This is the seventh consecutive year that Media Mail/Library Mail did not generate sufficient revenues to cover attributable costs. The Postal Service explains that under the price increases that went into effect on January 26, 2014, Media Mail/Library Mail's cost coverage is expected to improve to 94.3 percent in FY 2014. FY 2013 ACR at 35 n.18. The Postal Service further elaborates that it plans to attempt to improve the product's cost coverage over time through price increases. FY 2013 ACR at 35.

Public Representative Comments

The Public Representative notes that Media Mail/Library Mail requires special attention since it consistently has not covered its attributable costs. PR Comments at 34. The Public Representative compares Media Mail/Library Mail's mail processing costs for FY 2013 and FY 2012. *Id.* Based on his analysis, the Public Representative states that unit mail processing costs for all Media Mail/Library Mail price categories increased from FY 2012 to FY 2013. *Id.* Consequently, he concludes that the unit mail processing cost increases raise concerns about Media Mail/Library Mail's compliance with section 3622(c)(2) in FY 2013 and its ability to comply in FY 2014. *Id.*

Commission Analysis

Media Mail/Library Mail did not cover its attributable costs or make a contribution to institutional costs in FY 2013. While this product may not be consistent with section 3622(c)(2) (cost coverage), the Commission must also consider the 9 objectives and 14 factors in their totality, such as the pricing factor outlined in section 3622(c)(11). Section 3622(c)(11), which is especially relevant to Media Mail/Library Mail, requires the Commission to take into account the educational, cultural, scientific, or informational value to the recipient of the mail matter.

The Postal Service has used its pricing flexibility to consistently propose above-inflation price increases for Media Mail/Library Mail in order to bring the revenues for this product closer to 100 percent cost coverage. The above-inflation price increases should eventually produce prices that are consistent with section 3622(b)(5) (to ensure adequate revenues to maintain financial stability). Therefore, despite Media Mail/Library Mail's failure to cover costs, the Commission does not find that Media Mail/Library Mail was inconsistent with section 3622 in FY 2013. Table III-3 shows the history of price increases for Media Mail/Library Mail under the PAEA.

Table III-3
Media Mail/Library Mail Price Adjustment versus Price Adjustment Authority Comparisons

Docket No.	Price Adjustment	Price Adjustment Authority (Price Cap)
R2008-1	4.538%	2.900%
R2009-2	7.468%	3.800%
R2011-2	1.964%	1.741%
R2012-3	2.581%	2.133%
R2013-1	3.469%	2.570%
R2013-10	2.061%	1.696%

Source: PRC Package Services Price Cap Adjustment Workpapers.

Nevertheless, the Commission agrees with the Public Representative that Media Mail/Library Mail requires special attention to ensure that this product becomes profitable for the Postal Service. The Commission encourages the Postal Service to continue pricing the Media Mail/Library Mail product in a way that brings the product towards full cost coverage.

Stamp Fulfillment 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 in Kansas City, Missouri. Stamp Fulfillment Services was added to the Mail Classification Schedule as a market dominant product in FY 2010. Since its introduction, SFS costs have exceeded its revenues such that the cost coverage is below 100 percent. However, Table III-4 shows that the SFS cost coverage for FY 2013 improved 21.5 percentage points from that reported in the FY 2012 ACD.

Table III-4
Stamp Fulfillment Services Cost Coverage[25]

ACD Year	Cost Coverage
FY 2010	53.1 percent
FY 2011	59.7 percent
FY 2012	59.3 percent
FY 2013	88.8 percent

[25] FY 2012 ACD at 142. *See also* Notice of the United States Postal Service of Revisions to the FY 2013 Annual Compliance Report – Errata, February 6, 2014, at 37. (FY 2013ACR Errata) Percentages are rounded to the nearest tenth of a percent.

Commission Analysis

The substantial increase in cost coverage is traceable to a 19 percent increase in unit revenue and a 6. 5 percent decrease in unit attributable cost. The increase in unit revenue was mostly due to the elimination of the $1.00 domestic fee for customers requesting SFS in FY 2013. Prior to this change, there were three domestic fee levels that varied by the value of the order ($1.00, $1.25, and $1.75). With the elimination of the $1.00 charge, customers either pay the $1.25 or $1.75 domestic fee. This increases the unit revenue from $1.27 in FY 2012 to $1.51 in FY 2013. *See* PRC-ACR2013-LR-5. The unit handling cost appears to have decreased because of a productivity gain that resulted in a 7 percent reduction in handling minutes per order. *See* PRC-ACR2013-LR-5.

In FY 2010 and FY 2011, SFS and the philatelic revenues and costs were reported together in the applicable CRA. In response to an FY 2010 and FY 2011 CHIRs, the Postal Service estimated the proportion of revenues and costs attributable to SFS without philatelic services.[26] In January 2012, the Postal Service implemented a relatively large SFS price increase and expected a significant improvement in the cost coverage. Consequently, the Commission concluded that no further action was required. However, the Commission recommended that the Postal Service report revenues and volumes for SFS and philatelic products separately in the FY 2013 RPW. *Id.*

In FY 2012, the SFS cost coverage was 0.4 percentage points lower than in FY 2011. The Postal Service asserted that had the FY 2012 rate increase been in effect for an entire fiscal year, the cost coverage would have improved significantly.[27] The Postal Service stated that it would "continue to attempt to move the cost coverage toward 100 percent through price adjustments." FY 2012 ACD at 142. *The Postal Service should continue to improve the cost coverage for this product.*

Inbound Letterpost (at UPU Rates)

The Inbound Letterpost (at UPU rates) product consists of inbound letterpost items entered by foreign postal operators.[28] Foreign postal operators remunerate the Postal Service for the delivery of inbound letterpost items at UPU terminal dues rates or negotiated rates established in bilateral or multilateral agreements.

For FY 2013, revenues for the Inbound Letterpost (at UPU rates) product did not cover attributable costs. The reported loss was $83.2 million, an increase from the $65.3 million loss in FY 2012. The cost coverage also decreased to 63.5 percent in FY 2013 from 67.3 percent in FY 2012. The decrease in contribution and cost coverage between FY 2013 and FY 2012 reflect a total unit cost increase that was greater than the increase in total unit revenue.

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[26] FY 2010 ACD at 29 n.43. *See also* FY 2011 ACD at 142.

[27] *Id.*; *see also* FY 2012 ACR at 32.

[28] 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 objects, including flats and small packets), letterpost consists of mail similar to domestic First-Class Mail, Periodicals, Standard Mail, Bound Printed Matter, and Media Mail/Library Mail, weighing up to 4.4 pounds (2.0 kilograms).

The smaller total unit revenue increase compared to the total unit cost increase follows from a decrease in unit revenue from Target System countries—the largest source of Inbound Letterpost—that more than offset the increase in unit revenue from Transition System countries.[29] Domestic transportation costs for Inbound Letterpost on a pound basis increased approximately 10 percent. Response to CHIR No. 3, question 7. The Postal Service states another contributing factor to the total unit cost increase was a 15 percent increase in weight per piece for Inbound Letterpost from Transition System countries, resulting in double-digit increases in Transition System country unit mail processing, delivery and transportation costs. *Id.*

Under the UPU's Quality Link Measurement System (QLMS), terminal dues payments to the Postal Service are adjusted, positively or negatively, depending upon whether service performance achieves the UPU-established annual quality of service performance target. In FY 2013, revenue from Inbound Letterpost (at UPU rates) was adversely affected by adjustments to terminal dues payments for the quality of service provided by the Postal Service. This reduction reflects the fact that the Postal Service's final on-time service performance scores did not meet the UPU quality of service target of 88 percent in CY 2012.[30] As a result, the Postal Service had to forgo additional revenue, albeit small, as it also incurred penalties during CY 2012, which includes the first quarter (October-December 2012) of FY 2013.

Preliminary on-time service performance scores for the months of January through November 2013 show a decline during the first-half of the year, and improvement thereafter, compared to the same preliminary monthly scores reported in CY 2012. *Id.* Notwithstanding this improvement, the preliminary monthly scores do not meet or exceed UPU quality of service target. Consequently, the final annual service performance score is not expected to meet or exceed the UPU quality of service target of 88 percent in CY 2013. This in turn would result in a small but negative effect on Postal Service revenue for the Inbound Letterpost (at UPU rates) product, although there is a lag in making the final CY 2013 adjusted terminal dues payments.

More generally, the Postal Service observes that the failure of Inbound Letterpost (at UPU rates) revenue to cover attributable costs "stems from the product's unique pricing regime."[31] Prices are set "according to a Universal Postal Union (UPU) terminal dues formula . . . for the majority of mail, the formula is based upon a percentage of the one ounce retail Single-Piece First-Class Mail price, [and for] the remainder . . . [prices are] based on a set rate per kilo," 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.*

[29] The target system refers to the UPU system of terminal dues payments to designated postal operators for the delivery of Inbound Letterpost in "target" countries, primarily industrialized countries, from other Target System designated operators at rates linked to the domestic postal rates in the country of delivery. The Transition System refers to terminal dues payments to designated postal operators for the delivery of inbound letterpost in "transition" countries, primarily developing countries, from Transition System and Target System designated operators at a fixed rate per kilogram. Unlike the target system, Transition System terminal dues rates are generally not ad justed for quality of service, although Transition System designated operators are expected to transition into the Target System overtime.

[30] Responses of the United States Postal Service to Questions 1-14 of CHIR No. 3, question 5, January 27, 2014. The information was filed under seal in Library Reference USPS-FY13-NP33.

[31] Notice of the United States Postal Service of Revisions to the FY 2013 Annual Compliance Report—Errata, February 6, 2014, at 11 (Revised FY 2013 ACR).

The Public Representative is the only party to comment on the Inbound Letterpost (at UPU rates) product. The Public Representative states that given the "pricing regime for inbound single-piece [letterpost], [it] does not believe [Inbound] First-Class Mail rates were out of compliance in FY 2013." PR Comments at 24.

The noncompensatory nature of inbound letterpost means that domestic mailers continue to subsidize foreign mailers who use the same postal infrastructure, while bearing none of the burden of contributing to its institutional cost. However, the Commission recognizes that the pricing regime for the Inbound Letterpost (at UPU rates) product, based upon the current UPU formula, results in terminal dues rates that are not compensatory. The Commission therefore does not recommend any remedial action at this time.

During the past several years the United States Delegation, which included representatives from the Commission, played an active role in UPU negotiations to develop a more compensatory terminal dues formula for inbound letterpost. Those negotiations were concluded in 2012, resulting in the adoption of a new formula to calculate terminal dues rates. Under the formula, new terminal dues rates, effective in CY 2014, will rise by double digits. According to the Postal Service, the new terminal dues rates "are expected to have a positive effect on [inbound letterpost] revenue and cost coverage for both target and transition countries." Revised FY 2013 ACR at 11. The Commission notes that similar increases in UPU terminal dues rates will also occur during CY 2015, 2016, and 2017.

In recent years, the Postal Service has entered into bilateral agreements with a number of foreign postal operators that include negotiated terminal dues rates as an alternative to the UPU terminal dues rates for some or all of its inbound letterpost items. These negotiated rates are designed to improve the overall cost coverage for inbound letterpost. In FY 2013, bilateral agreements were in effect with the following foreign postal operators: Australia Post, Canada Post, the China Post Group, Hongkong Post, Royal PostNL (Netherlands), and Singapore Post.

Under current circumstances, the Commission recommends that the Postal Service continue to negotiate more compensatory bilateral (or multilateral) agreements with foreign postal operators in the upcoming fiscal year.

MARKET DOMINANT NEGOTIATED SERVICE AGREEMENTS (NSAs)

NSAs are contracts between a specific mailer and the Postal Service that provide the mailer 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. For the ACD, the Commission reviews the contract year that ends during the fiscal year of the ACD.

In FY 2013, the Postal Service had two domestic market dominant NSAs in effect: Discover (DFS) and Valassis. Contract year 2 of the NSA with DFS (Docket Nos. MC2011-19 and R2011-3) ran from April 1, 2012 through March 31, 2013, (and was thus completed during FY 2013). The Postal Service was authorized to implement an agreement with Valassis (Docket Nos. MC2012-14 and R2012-4) in FY 2012. Valassis sent no mail under the agreement in FY 2013. FY 2013 ACR at 38. Table III-5 shows the net effect on the contribution to institutional costs of the NSAs in effect during FY 2013.

Table III-5
Summary of NSA Net Effect on Contribution for NSAs in Effect in FY 2013

($ Thousands)			
	FY 2012	FY 2013	Total
Discover	$(4,338)	$(6,861)	$(11,199)
Valassis		$ -	$ -

Source: PRC-ACR2013-LR-6.

Discover NSA

When requesting approval of the DFS 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."[32] Pursuant to the agreement, DFS receives rebates on "qualifying mail"[33] if its total revenue exceeds the agreed upon revenue threshold.[34] In contract year 2, the revenue threshold was $276.5 million, which DFS exceeded by $10.3 million.[35] The DFS NSA provides DFS with a rebate of a portion of the generally applicable market dominant price increases during the contract for eligible volume (75 percent of the price increase for First-Class Mail and 37.5 percent of the price increase for Standard Mail). Table III-6 details the rebate calculation for contract year 2. As detailed in Table III-6, DFS received rebates of $9,233,198 in contract year 2 on 1.095 billion pieces qualifying for the rebate.

[32] 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).

[33] Discover earns rebates on all IMb mail pursuant to the agreement. Mail that qualifies for other promotions, such as the mobile barcode promotion, or is not pre-barcoded with an IMb does not qualify for rebates pursuant to the NSA.

[34] The NSA has a threshold adjustment mechanism aimed at maintaining Discover's First-Class Mail revenue. In contract year 2, Discover generated $1.1 million less First-Class revenue than in the baseline period. Consequently, the threshold adjustment was activated. The First-Class Mail revenue adjustment increases the total revenue threshold by 0.65 percent of the decrease in First-Class Mail revenue. The threshold increased by $718,323 in contract year 2 due to the First-Class Mail adjustment. $1,105,112 multiplied by 0.65 is $718,323.

[35] The rebate threshold for contract year 2 is 115 percent of the Discover eligible revenue during the baseline period. The baseline eligible revenue was $239.7 million. $239.7 million multiplied by 1.15 is $275.8 million. The revenue threshold also includes a mechanism for encouraging DFS to maintain revenue for First-Class Mail. As detailed in Table III-8, DFS First-Class Mail revenue in contract year 2 was below the First-Class Mail revenue in the baseline period. Thus, in contract year 2, the First-Class Mail threshold adjustment mechanism increased the overall revenue threshold. The First-Class Mail revenue threshold adjustment for contract year 2 was $718,323, which was added to the unadjusted threshold of $275.8 million to make the overall threshold $276.5 million.

Table III-6
Calculation of DFS Contract Year 2 Rebate

	First Class	Standard	Total
Eligible Volume	211,338,333	883,592,442	1,094,930,775
Rebate Per Piece	$0.018	$0.006	
Total Rebate	$3,746,032	$5,487,186	$9,233,198

Source: PRC-ACR2013-LR-6.

Because the NSA is targeted at maintaining or increasing the overall contribution from DFS's volume, it is informative to evaluate how volume, revenue, and contribution changed from the baseline period to the contract year 1 period, and to the contract year 2 period. When the Postal Service proposed the DFS NSA, it used DFS's FY 2010 volume as an estimated baseline. Table III-7 compares the total revenue and contribution generated by DFS in the baseline and first two contract years. Table III-8 details the volume breakdown between First-Class Mail and Standard Mail during those same periods.

Table III-7
DFS 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
Contract Year 2 Before Rebate	$285,483,706	$175,079,248
Contract Year 2 After Rebate	$276,250,507	$165,846,050

Note: baseline, contract year 1, and contract year 2 revenue and contribution do not include any promotional discounts, such as summer sales and QR code discounts.

Source: PRC-ACR2013-LR-6.

Table III-8
DFS Total First-Class and Standard Mail 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	829,530,946	$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
Contract Year 2	216,156,648	$79,445,741	992,100,690	$206,037,964	1,208,257,338	$285,483,706

Note: baseline, contract year 1, and contract year 2 volume figures include all mail, including non qualifying discounted volume.

Source: PRC-ACR2013-LR-6.

In FY 2010, DFS mailed 224 million pieces of First-Class Mail and 604 million pieces of Standard Mail, for a total of 829 million pieces. In the baseline period used for calculating the rebate threshold of February 1, 2010 through January 31, 2011, DFS 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), DFS increased its volume by 236 million pieces. DFS further increased its volume by 83.2 million pieces in contract year 1. It increased volume by an additional 59.6 million pieces in contract year 2.

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 the methodology discussed below. Docket Nos. MC2011-19 and R2011-3, Notice at 5. The Postal Service provided estimates of DFS contract year 2 volumes as part of its Docket No. R2011-3 filing. Table III-9 details the DFS FY 2010 volume, the Postal Service's estimate of DFS contract year 2 volume at the time of proposal, the actual baseline volume, and DFS's contract year 2 volume.

Table III-9
DFS Estimated and Actual Volumes

	Discover FY 2010 Volume	Postal Service Projection of Contact Year 2 Volume	Discover Pre-Implementation Volume - February 2010 to January 2011	Contract Year 2 Volume - April 2012 to March 2013
	(1)	(2)	(3)	(4)
First-Class	224,761,744	182,057,013	225,319,325	216,156,648
Standard - Low	604,769,202	722,927,665	840,100,963	992,100,690
Standard - High	N/A	767,680,586	N/A	N/A
Total	829,530,946	904,984,687 to 949,737,598	1,065,420,288	1,208,257,338

Source: PRC-ACR2013-LR-6.

In its FY 2013 ACR, the Postal Service estimates that the DFS NSA resulted in a net contribution increase of between $26.5 million and $31.9 million. It calculates net contribution by comparing contract year 2 actual results (column 4 above) with Postal Service projected year 2 volumes (column 2 above). Table III-10 details the Postal Service estimate of net contribution.

Table III-10
Postal Service Estimate of Net Contribution

	YR 2 Projected Volume	YR 2 Actual Volume							
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
	W/O Incentives (Before Rates)	With Incentives (After Rates)	Incremental	Unit Rev/pc	Unit Cost/pc	Unit Contribution	Total Contribution	Rebate	Net USPS Value
First-Class	182,057,013	216,156,648	34,099,635	$0.368	$0.107	$0.260	$8,874,042	$3,746,032	$5,128,010
(Low Volume Estimate)									
Standard Mail	722,927,665	992,100,690	269,173,025	$0.208	$0.107	$0.120	$32,239,679	$5,487,166	$26,752,513
Total	904,984,677	1,208,257,338	303,272,661				$32,467,425	$5,623,954	$31,880,522
(High Volume Estimate)									
Standard Mail	767,680,586	992,100,690	224,420,104	$0.208	$0.088	$0.120	$26,879,484	$5,487,166	$21,392,318
Total	**949,737,598**	**1,208,257,338**	**258,519,740**				**$30,430,399**	**$5,623,954**	**$26,520,328**

Source: PRC-ACR2013-LR-6.

The Postal Service's net contribution method assumes that all volume greater than the projected contract year 2 volume is due to the rebate.[36] For First-Class Mail, this amounted to 34.1 million pieces. The unit contribution of DFS's First-Class letters is, on average, 26.0 cents per piece. Thus, the total contribution from the 34.1 million pieces was $8.9 million. The First-Class rebate was $3.7 million. The Postal Service estimates the net value after the First-Class rebate to be $5.1 million.

For Standard Mail, the Postal Service develops two alternative assumptions: Standard Mail – Low and Standard Mail – High. The Postal Service estimates that between 224 million and 269 million pieces of Standard Mail are due to the rebate. The unit contribution of DFS's Standard letters is, on average, 12.0 cents per piece. Thus, the 224 to 269 million incremental pieces had a contribution of $26.9 million to $32.2 million. The Standard Mail rebate was $5.5 million. The Postal Service estimates the net value after the Standard Mail rebate to be $21.4 million to $26.8 million.

The Postal Service combines its net value calculations for First-Class and Standard Mail and estimates that the DFS NSA increased net contribution by between $26.5 million and $31.9 million in contract year 2.

[36] This includes 4.8 million First-Class Mail pieces and 108.5 million Standard Mail pieces ineligible for the discounts.

Comments from Valpak

One commenter, Valpak, addressed the DFS NSA. In its reply comments, Valpak summarizes the net effect on contribution due to all market dominant NSAs from FY 2009 to FY 2013 as -$35.5 million. Valpak states that the "Postal Service has demonstrated that it has not yet learned to use its much vaunted 'pricing flexibility' to fashion profitable Market Dominant negotiated service agreements." Valpak Reply Comments at 37. Valpak comments that the "time has come for the Commission to order the Discover NSA be terminated forthwith." *Id.* at 38 (footnote omitted).

Commission Analysis

When proposing the NSA, the Postal Service used DFS's FY 2010 volume to project what DFS would mail without an agreement in contract year 2. This projection is contained in Table III-9 column 2. The Postal Service estimated that, without a rebate, DFS would increase its overall volume from 829 million to between 905 and 950 million pieces in contract year 2. The Postal Service uses the projected volume of between 905 and 950 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 2 was caused by the rebate.

As shown in Table III-9, DFS increased its volume by 236 million pieces in the 4 months between the proposal and implementation of the NSA, from 830 million pieces to 1.065 billion pieces. DFS further increased its volume by 59.6 million pieces to 1.208 billion pieces in contract year 2.

As detailed in Table III-9, column 3, the Postal Service assumes that between 259 million and 303 million pieces were incentivized by the rebate. DFS's volume increased by 83.2 million in contract year 1 and 59.6 million in contract year 2. *See* Table III-9. The majority of the volume (237 million pieces) that the Postal Service assumes was incentivized by the rebate was mailed by DFS before the rebates were being offered.[37]

The Postal Service's estimates of the NSA's net benefits are not based on any quantitative factors.[38] To develop its estimates, the Commission uses the accepted methodology, the purpose of which is to estimate mailer response to a lower price using quantitative inputs. The accepted methodology incorporates the contract year 2 rebated volume, the marginal rebate, and the Standard Regular

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[37] As detailed in Table III-9, DFS volume increased from 830 million pieces in FY 2010 to 1.065 billion pieces in the baseline period, an increase of 236 million pieces. In Docket No. R2011-3, the Postal Service estimated that DFS volume would be 905 to 950 million pieces, as detailed in Table III-10. DFS mailed 1.208 billion pieces in contract year 2, an increase of 258 million to 304 million pieces as compared with the Postal Service's projection of year 2 volume. As DFS mailed 1.065 billion pieces before the agreement began, DFS volume increased by 116 million and 160 million pieces compared to the Postal Service's contract year 2 projections before the agreement began. Thus, between 38 percent and 62 percent of the volume increase the Postal Service estimates is due to the agreement, occurred before the agreement was implemented. The calculations are as follows: 116 million/303 million is 38 percent, and 160 million/224 million is 62 percent.

[38] The Postal Service's method for estimating the net value of the DFS NSA is a function of the following inputs: DFS contract year 2 volumes projected in Docket No. R2011-3, DFS contract year 2 volumes, and estimated unit contribution. In Docket No. R2011-3, the Postal Service provided a list of qualitative factors it used to estimate the DFS contract year 2 projected volumes. *See* Order No. 694 at 13. The Commission has previously encouraged the Postal Service to develop quantitative methods for estimating net value of NSAs. *See* Docket No. RM2010-9, in which the Commission attempted to develop alternative quantitative methods for estimating volume responses to pricing incentives.

and First-Class workshared subclass own-price elasticities.[39] The Commission recognizes that the elasticity of individual mailers may differ from that of the subclass as a whole; however, the Commission methodology uses subclass elasticities because they are the only elasticity estimates produced by the Postal Service at this time.

In contract year two, 211.3 million First-Class Mail pieces qualified for the marginal rebate of 1.8 cents per piece.[40] Using the 2013 First-Class workshared subclass elasticity of 0.339, 3.5 million pieces were incentivized by the rebate. Therefore, the Postal Service gained $0.9 million in contribution from these pieces.

In contract year two, 883.5 million Standard pieces qualified for a 0.6 cent rebate.[41] Using the 2013 Standard Regular elasticity of -0.457, 12.2 million pieces were incentivized by the rebate. Thus, the Postal Service gained $1.5 million in contribution from these pieces. Using the Commission's accepted methodology, the estimated increase in contribution from incentivized volume in contract year 2 of the DFS NSA is about $2.4 million. However, since the Postal Service paid rebates of $3.7 million for First-Class Mail volumes and $5.5 million for Standard Mail volumes, the estimated net benefit to the Postal Service of the NSA with DFS in contract year 2 was a negative $6,891,160.[42]

The Postal Service estimates that 34.1 million First-Class Mail pieces were incentivized by the rebate. DFS would need to have an elasticity of -3.33 to be incentivized to mail 34.1 million pieces by a marginal rebate of 1.8 cents. This is roughly 10 times the own-price elasticity of workshared First-Class Mail as a whole. The Postal Service estimates that over 224 million Standard pieces were incentivized by the rebate. DFS would need an elasticity of -5.03 to be incentivized to mail 224 million pieces by a marginal rebate of 0.6 cents, roughly 11 times the own-price elasticity of Commercial Standard Regular Mail as a whole.

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[39] 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 2013 Standard Mail Regular elasticity is -0.457 and the First-Class Workshared Letters, Flats, and Cards elasticity is -0.339, as provided in the attachment to the January 20, 2014 letter from Andrew German. The Postal Service provides its estimates of price elasticity pursuant to the Commission's Periodic Data Reporting Rules.

[40] *See* Table III-6, eligible First-Class volume.

[41] *See* Table III-6, eligible Standard volume.

[42] The formula for estimating the incremental volume incentivized by a rebate is Eligible Volume x [(1 - Revenue per piece)/(Revenue per piece - marginal rebate)] ^ 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.

Among other things, 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 unreasonable harm to the marketplace. The DFS 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 2013. This does not mean that revenues did not cover attributable costs for this mail, rather the aggregate contribution was reduced from what it would have been absent the agreement. When approving the NSA, the Commission expressed reservations about the quantitative methods used by the Postal Service to estimate what DFS's net contribution would be in absence of the NSA.[43] It further noted that "[i]t is incumbent upon the Postal Service to develop a quantitative approach that incorporates the factors it is using to estimate volumes." *Id.* at 14. Using the accepted elasticity test, the Commission concluded that the NSA was unlikely to improve the Postal Service's net financial position using the approved methodology. *Id.* The Commission also evaluated the agreement using an analysis presented by the Public Representative. While the Commission did not endorse that method, it encouraged the Postal Service to explore that approach when analyzing similar agreements. *Id.* at 14-15. Recognizing that "[t]he context of the Postal Service's proposal is important," the Commission authorized the NSA to proceed, stating "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 offers no statements in either the ACR or responses to CHIRs regarding what management may have learned from the DFS NSA. In the FY 2012 ACD, the Commission noted that the agreement had a negative effect on the net financial position of the Postal Service, and that the Postal Service should consider canceling the agreement if the results for contract year 2, which ended March 31, 2013, were similar. The Postal Service did not follow that recommendation.[44] Further, given that contract year 3 terminates March 31, 2014, four days after the issuance of the ACD, the Commission finds it unnecessary to act on Valpak's suggestion that the agreement be terminated.

The Commission finds that, under the existing methodology, the DFS NSA would have satisfied section 3622(c)(10) if the total rebate was less than $2.4 million in contract year 2.[45] The agreement implemented by the Postal Service was designed to pay rebates for all of DFS's qualifying volume, and in contract year 2 the rebate was greater than the contribution incentivized by the agreement. As implemented by the Postal Service, the NSA is inconsistent with section 3622(c)(10). The DFS NSA completes its third and final contract year on March 31, 2014. The Commission directs the Postal Service to provide in its FY 2014 ACR, a detailed analysis of the lessons learned from the DFS NSA. Specifically, the Postal Service shall address: (1) how well the NSA achieved its goal of maintaining DFS's total contribution from First-Class Mail and Standard Mail; (2)

[43] *See* Docket Nos. MC2011-19 and R2011-3, Order No. 694, Order Adding Discover Financial Services 1 Negotiated Service Agreement to the Market Dominant Product List, March 15, 2011, at 13.

[44] In March 2013, the Postal Service filed an amendment to the DFS contract. This amendment modifies the calculation of the adjusted revenue threshold for contract year 3. For contract year 3, the DFS Priority Mail volume will be considered First-Class Mail, with the average First-Class Mail revenue per piece, for threshold purposes. In Order No. 1720, the Commission approved this amendment to the DFS NSA for contract year 3. The Postal Service will provide information on contract year 3 in June of FY 2014.

[45] The contribution from the volume incentivized by the rebate was $2.4 million.

how well the NSA achieved its goal of providing an incentive for growth in net contribution beyond that; (3) the lessons the Postal Service has learned regarding methods for staunching First-Class Mail volume declines; and (4) what efforts the Postal Service has made to develop a net value method with quantitative inputs.

Valassis NSA

On April 30, 2012, the Postal Service filed notice of its agreement with Valassis.[46] On August 23, 2012, in Order No. 1148, the Commission approved the Valassis NSA.[47] Order No. 1448 was appealed to the United States District Court of Appeals. On November 15, 2013, the District Court denied the petition for review.[48] In its ACR, the Postal Service states "Valassis did not send enough NSA-eligible volume to qualify for volume discounts, and paid published rates during FY 2013. Therefore, there are no further data to report." Pursuant to the Valassis Agreement Part IV. Subpart G., "Valassis must initiate mailing Contract Pieces under this agreement within 90 days following the Effective Date of this agreement." Valassis Request, Attachment B at 3. Further, Valassis Agreement Part IV. Subpart G.2. states that if Valassis does not mail 1 million pieces pursuant to the agreement in the first month, it must pay the Postal Service a one-time fee of $100,000. The Postal Service explained that "the Postal Service has not yet collected this payment, it is currently discussing the payment with Valassis." Response to CHIR No. 4, question 14.

Comments from Newspaper Association of America

NAA filed comments regarding the Valassis agreement. The Postal Service and Valpak discussed the NAA comments in reply comments.

In its initial comments, NAA detailed how the Postal Service had not complied with the data collection and reporting requirements of Order No. 1448. NAA "urges the Commission to require the Postal Service to comply with its data collection and reporting obligations, and to provide fully the information required under Order No. 1448." NAA Comments at 4-5.

In its reply comments, Valpak agreed with NAA that the Commission should require the Postal Service to file the data collection report immediately. Valpak notes that the failure of the Postal Service to file the data collection report "should demonstrate to the Commission that the Postal Service does not take the Commission's statutory role and regulatory authority seriously." Valpak Reply Comments at 21.

The Postal Service argues in its reply comments that the Periodic Data Collection report was not necessary. The Postal Service acknowledges that it did not file the data collection report, but states that "subsequent information filed in this ACR docket make[s] such a report unnecessary." Postal Service Reply Comments at 13. The Postal Service adds "[a]s no contract pieces were mailed, there is no additional data for the Postal Service to report." *Id.*

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[46] *See* Docket Nos. MC2012-14 and R2012-8, Notice of the United States Postal Service of Filing of Contract and Supporting Data and Request to Add Valassis Direct Mail, Inc. Negotiated Service Agreement to the Market-Dominant Product List, April 30, 2012 (Valassis Request).

[47] *See* Docket Nos. MC2012-14 and R2012-8, Order Approving Addition of Valassis Direct Mail, Inc. Negotiated Service Agreement to the Market Dominant Product List, August 23, 2012 (Order No. 1448).

[48] *Newspaper Ass'n of America v. Postal Regulatory Comm'n*, 734 F.3d 1208 (D.C. Cir. 2013).

Commission Analysis

The Valassis agreement became effective "the day on which the Commission issues all necessary regulatory approval." Valassis Request, Attachment B at 5. Order No. 1448 directs the Postal Service to file a data collection report within 60 days of the end of each contract year. Order No. 1448 at 41. The Postal Service shall file the required report for all subsequent contract years. In addition, Order No. 1448 requires the Postal Service to "notify the Commission within 30 days of when the Valassis NSA becomes operational in a market." *Id.* at 42. *Within 30 days of the issuance of this ACD, the Postal Service shall notify the Commission of the markets in which the Valassis NSA is operational.*

NONPOSTAL SERVICES

In FY 2013, nonpostal services[49] generated $48.1 million in revenue and incurred $8.7 million in expenses, which resulted in a net income of $39.4 million. This figure represents a 23 percent decrease compared to FY 2012.

OTHER ISSUES

First-Class Mail Product Cost Coverage

Pitney Bowes argues that the disparity in unit contribution and cost coverage of First-Class Single-Piece and Presort Letters cannot be justified. Pitney Bowes Comments at 2. It believes this disparity harms the Postal Service financially and discourages the growth and retention of the Postal Service's most profitable First-Class Mail product. Pitney Bowes suggests that the Postal Service should rebalance cost coverages and unit contributions among First-Class Mail products. Pitney Bowes contends that the Postal Service could increase total contribution from First-Class Mail by lowering prices on Presort Letters. *Id.* The Postal Service responds that the Commission's findings in the FY 2012 ACD—that the PAEA gives the Postal Service pricing flexibility, that the Postal Service has used discounts to mitigate price increases, and that the comments and reply comments provided insufficient information to conclude that differing price increases were unreasonable—continue to apply in FY 2013. Postal Service Reply Comments at 13-14.

Both Single-Piece Letters/Postcards and Presort Letters/Postcards, the products that contain the categories in question, covered costs in FY 2013. As the Commission noted in response to similar concerns expressed in the FY 2012 ACD proceeding, one objective of the PAEA was to allow the Postal Service pricing flexibility, subject to an inflation-based cap on price changes. *See* FY 2012 ACD at 82. That flexibility can be used to apply non-uniform price adjustments within a class. *Id.*; 39 U.S.C. 3622(b)(8). The Commission continues to encourage the Postal Service to use its pricing flexibility to "balance its own needs with the operational realities of the mailing communities it serves." Order No. 1926 at 168.

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[49] The two market dominant products are: (1) Alliances with the Private Sector to Defray Cost of Key Postal Functions; and (2) Philatelic Sales. Docket No. MC2012-24, Order Approving Mail Classification Schedule Descriptions and Prices for Nonpostal Service Products, December 11, 2012, at 4. (Order 1575).

Metered Letter Prices

The Greeting Card Association (GCA) is concerned that the Metered Letter prices that went into effect January 26, 2014, fail to satisfy 39 U.S.C. 3622(b)(8), which requires that the system of rate regulation have as one of its objectives the establishment and maintenance of a just and reasonable schedule for rates and classifications. GCA Comments at 1. Additionally, GCA contends that, based on the limited information currently available, the Metered Letter prices have not incentivized greater use of meters; rather, mailers who were already using meters were rewarded with a discount. It further asserts that the rate structure of Metered Letters is irrational. *Id.*

GCA requests that the Commission require the Postal Service to provide certain information regarding Metered Letters in the FY 2014 ACR, including: (1) information on the effect of the differential between Stamped Letters and Metered Letters in stimulating new meter usage; (2) information on any significant increase in the volume of Metered Letters, and/or in the fraction of all Single-Piece Letters they represent; (3) information sufficient to establish the cost savings from converting a letter from stamped to metered postage payment; and (4) an explanation and justification for the seemingly irrational structure of the differential, whereby it is made to apply separately to each ounce increment up to the weight limit for Metered Letters. *Id.* at 1-2.

The Postal Service and Pitney Bowes oppose GCA's request. They argue that the information GCA seeks would be relevant only if the rate differential between Stamped Letters and Metered Letters constituted a workshare discount. Postal Service Reply Comments at 7-8 and Pitney Bowes Reply Comments at 2. The Postal Service contends that the Metered Letter price does not meet the statutory definition of "workshare discount" established by 39 U.S.C. 3622(e)(1). Postal Service Reply Comments at 8. Additionally, Pitney Bowes argues that GCA's request is contrary to the objective established by 39 U.S.C. 3622(b)(6) – to "reduce administrative burden." Pitney Bowes Reply Comments at 2.

The Commission does not find GCA's reasons for requiring the Postal Service to provide additional information regarding Metered Letters in the FY 2014 ACR compelling. Because the Commission has not determined that a worksharing relationship exists between Stamped and Metered Letters,[50] information regarding the cost differential between Stamped and Metered Letters is not likely to aid the Commission in determining whether the rates and fees comply with the provisions of chapter 36, United States Code. *See* 39 U.S.C. 3653(b)(1). Nonetheless, beginning this fiscal year, volume information for the new Metered Letters and Stamped Letters rate categories will be available in the billing determinants filed quarterly by the Postal Service. The billing determinants can be used to calculate the fraction of all Single-Piece Letters that Metered Letters represent.

[50] *See* Order No. 1890 at 49-50 (discussing the findings required before the Commission can determine that the rates for Metered and Stamped Letters establish a workshare discount).

GCA's assertion that the rate structure for Metered Letters may be irrational is not well supported. As the Postal Service explains, only the price for one-ounce machinable pieces reflects separate pricing for Metered Letters and Stamped Letters. Postal Service Reply Comments at 8 n.23. The price for a one-ounce single-piece machinable Metered Letter is $0.48.[51] The price for a one-ounce single-piece Stamped Letter is $0.49. *Id.* The lower Metered Letter price is consistent with the Postal Service's goal of encouraging the use of meters rather than stamps. *Id.* at 8. For both Metered Letters and Stamped Letters, the price for each additional ounce is $0.21. *See* MCS at 8-9. Since costs associated with weight are not affected by the type of indicia used, it is reasonable for the Postal Service to charge the same price for additional ounces, regardless of whether it applies to Metered Letters or Stamped Letters.

Periodicals Price-Cost Ratios for Bundles and Containers

The pricing of Periodicals rate elements, specifically Periodicals price-cost ratios for bundles and containers, is another issue raised by a commenter. Discrete pricing for Outside County bundles, sacks, and pallets was introduced in Docket No. R2006-1.

The prices, based on mail processing costs, and ratios of price to mail processing 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 are similar to worksharing discounts in the sense that they provide incentives for cost-reducing mail preparation behavior. Unlike worksharing discounts and passthroughs, price-cost ratios do not explicitly relate discounts to the costs avoided by additional mailer preparation. However, the prices reflect to varying degrees the processing costs imposed on the Postal Service by the mailer's choice of presort bundle level and container. Price-cost ratios are used to describe how much of the cost is recognized in a given price element.

Comments from Public Representative

The Public Representative notes that the Postal Service "reduced bundle, sack and pallet price cost ratios across the board this year." The Public Representative concludes that the Postal Service "has taken the Commission's suggestion into consideration." PR comments at 39.

Commission Analysis

In FY 2013, the price-cost ratios for bundles, sacks, and pallets continued to be significantly below 100 percent. As the Public Representative notes, many of these ratios increased in FY 2013. Price-cost ratios range from a low of 9.3 percent for a Mixed ADC pallet entered at the Origin Network Distribution Center (ONDC), to a high of 71.8 percent for an ADC pallet entered at the ONDC. Of the 58 prices for bundles and containers, 35 (or over 60 percent) were priced at less than 40 percent of the cost imposed on the Postal Service.

The range of price-cost ratios for two similar mail preparation options, Mixed ADC pallets and ADC pallets, highlight the disparate effects of the FY 2013 Periodicals prices. The price for entering a Mixed ADC pallet was $3.56 in FY 2013. The Postal Service maintains a low price for Mixed ADC pallets to encourage mailers who would otherwise enter sacks to enter their mail in pallets.

[51] MCS section 1105.5 (Prices).

Operationally, Mixed ADC pallets and ADC pallets entered at ONDC facilities are handled nearly identically, as they are opened and the bundles contained inside are processed at the ONDC facility that received the pallet. The price of an ADC pallet entered at an ONDC was $34.375 in FY 2013. As a result of these price signals, mailers entered nearly 4 times as many Mixed ADC pallets as ADC pallets in FY 2013.

In the most recent market dominant CPI price adjustment, Docket No. R2013-10, the Postal Service used its pricing flexibility to increase the prices of pallets, on average, by 1.59 percent. The Postal Service increased sack prices, on average, by 1.62 percent. The Postal Service did not leverage its pricing flexibility to address the gap between the costs imposed by bundles and containers and the prices the Postal Service charges for these elements.

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 incentivize more efficient mailer preparation and increase contribution from Periodicals. As part of the report required to be included in the FY 2014 ACR for Periodicals that is outlined above, the Postal Service must also include the progress in implementing the Commission's recommendation set forth herein for improving bundle and container pricing.

Table III-11
Within County Passthroughs FY 2013

Type of Workshare	Discount	Avoided Cost	Passthrough
Presorting (cents/piece)			
3-Digit Presort	1.20	1.70	70.6%
5-Digit Presort	1.30	12.40	10.5%
CR Basic	4.80	19.10	25.1%
High Density	1.70	2.50	68.0%
Saturation	1.40	3.40	41.2%
3-Digit Automation Letter	1.10	1.10	100.0%
5-Digit Automation Letter	0.20	2.04	9.8%
Barcoding (cents/piece)			
Basic Automation Flats	1.60	8.78	18.2%
3-Digit Automation Flats	1.20	9.53	12.6%
5-Digit Automation Flats	0.60	5.86	10.2%
Dropship (cents/piece)			
DDU Dropship	0.80	2.50	32.0%

Source: PRC-ACR2013-LR-3.

Table III-12
Outside County Passthroughs FY 2013

Type of Workshare	Discount	Avoided Cost	Passthrough
Presorting (cents/piece)			
Machinable Non-automation ADC Flats	3.6	5.5	65.5%
Machinable Non-automation 3D/SCF Flats	1.7	2.8	60.7%
Machinable Non-automation 5D Flats	10.3	8.4	122.6%
CR Basic	10.8	13.9	77.7%
High Density	3.3	2.5	132.0%
Saturation	2.1	3.4	61.8%
Machinable Automation ADC Flats	2.7	4.5	60.0%
Machinable Automation 3D/SCF Flats	1.6	2.6	61.5%
Machinable Automation 5D Flats	9.0	7.4	121.6%
Non-machinable Nonauto ADC Flats	12.1	9.5	127.4%
Non-machinable Nonauto 3D/SCF Flats	7.8	(2.5)	-312.0%
Non-machinable Nonauto 5D Flats	12.3	13.0	94.6%
Non-machinable Automation ADC Flats	10.0	9.5	105.3%
Non-machinable Automation 3D/SCF Flats	6.4	(2.2)	-290.9%
Non-machinable Automation 5D Flats	11.2	12.7	88.2%
Barcoding (cents/piece)			
Machinable Automation MADC Flats	3.3	3.1	106.5%
Non-machinable Automation MADC Flats	4.7	0.3	1566.7%
Presorting Automation Letters (cents/piece)			
ADC Automation Letter	4.1	1.5	266.3%
3-Digit Automation Letter	2.1	0.3	603.8%
5-Digit Automation Letter	6.4	2.0	313.8%

Source: PRC-ACR2013-LR-3.

Table III-13
Outside County Bundle Price-Cost Ratios FY 2013

Container Level	Bundle Level	Price ($)	Bottom-up Cost ($)	Price as Percent of Cost
Mixed ADC				
	MADC	0.081	0.169	47.9%
	ADC	0.213	0.465	45.8%
	3-D/SCF	0.283	0.581	48.7%
	5-D	0.292	0.629	46.4%
	Firm Bundle	0.190	0.778	24.4%
ADC				
	ADC	0.118	0.263	44.9%
	3-D/SCF	0.195	0.381	51.2%
	5-D	0.211	0.419	50.4%
	CR	0.333	0.607	54.9%
	Firm Bundle	0.158	0.600	26.3%
3-D/SCF				
	3-D/SCF	0.132	0.263	50.2%
	5-D	0.154	0.289	53.3%
	CR	0.295	0.467	63.2%
	Firm Bundle	0.146	0.465	31.4%
5-D/CR				
	5-D	0.149	0.263	56.7%
	CR	0.156	0.249	62.7%
Source: PRC-ACR2013-LR-3.	**Firm Bundle**	0.081	0.263	30.8%

Table III-14
Outside County Sack Price-Cost Ratios FY 2013

Sack Level	Entry Point	Price ($)	Bottom-up Cost ($)	Price as Percent of Cost
Mixed ADC				
	ONDC	0.449	2.449	18.3%
	OSCF	0.449	1.883	23.8%
	OADC	0.449	2.893	15.5%
ADC				
	OSCF	2.134	4.542	47.0%
	OADC	2.134	3.824	55.8%
	ONDC	2.134	$3.397	62.8%
	DNDC	1.492	2.893	51.6%
	DADC	0.853	1.883	45.3%
3-D/SCF				
	OSCF	2.238	5.155	43.4%
	OADC	2.238	4.437	50.4%
	ONDC	2.238	4.010	55.8%
	DNDC	1.599	3.506	45.6%
	DADC	1.279	2.844	45.0%
	DSCF	0.853	1.883	45.3%
5-D/CR				
	OSCF	2.877	6.670	43.1%
	OADC	2.877	5.874	49.0%
	ONDC	2.877	5.400	53.3%
	DNDC	2.132	4.841	44.0%
	DADC	1.812	4.107	44.1%
	DSCF	1.385	3.151	44.0%
	DDU	0.959	2.117	45.3%

Source: PRC-ACR2013-LR-3.

Table III-15
Outside County Pallet Price-Cost Ratios FY 2013

Pallet Level	Entry Point	Price ($)	Bottom-up Cost ($)	Price as Percent of Cost
Mixed ADC				
	ONDC	3.560	38.258	9.3%
	OADC	3.560	21.984	16.2%
	OSCF	3.560	38.258	9.3%
ADC				
	OSCF	34.375	57.552	59.7%
	OADC	34.375	54.623	62.9%
	ONDC	34.375	47.892	71.8%
	DNDC	23.717	38.258	62.0%
	DADC	13.129	21.984	59.7%
3-D/SCF				
	OSCF	40.719	60.426	67.4%
	OADC	40.719	57.497	70.8%
	ONDC	40.719	50.765	49.6%
	DNDC	25.199	41.131	53.3%
	DADC	21.917	37.933	57.8%
	DSCF	11.752	21.255	55.3%
5-D/CR				
	OSCF	53.370	104.413	51.1%
	OADC	53.370	91.310	58.4%
	ONDC	53.370	79.108	67.5%
	DNDC	33.776	66.258	51.0%
	DADC	31.975	63.615	50.3%
	DSCF	21.599	42.728	50.6%
	DDU	1.694	3.203	52.9%

Source: PRC-ACR2013-LR-3.

CHAPTER 4

COMPETITIVE PRODUCTS

INTRODUCTION

In this chapter, the Commission reviews competitive products to determine whether any rates or fees in effect during FY 2013 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 principal FY 2013 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 2013, 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): (1) Parcel Return Service Contract 4; (2) International Priority Airmail (IPA); (3) International Air Parcel Post (at non UPU rates); and (4) International Money Transfer Service—Outbound. The Commission directs the Postal Service to take corrective action.
- Competitive products, collectively, satisfied the Commission's 5.5 percent minimum contribution regulatory requirement. *See* 39 CFR 3015.7(c). As a result, competitive products complied with section 3633(a)(3) during FY 2013.

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 products; (2) attributable costs for international competitive products;[2] and (3) competitive group specific costs.

[1] Docket No. RM2010-4, Order Accepting Analytical Principles Used in Periodic Reporting (Proposals 22-25), 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.

For FY 2013, the hybrid incremental cost methodology produced incremental costs for competitive products, as a whole, of $10.1 billion. *See* Library Reference USPS-FY13-NP10. The total revenues for competitive products as a whole in FY 2013 were $13.7 billion. *See* PRC Financial Analysis Report, FY 2013. Accordingly, in FY 2013, revenues from competitive products exceeded the hybrid incremental costs.[3] *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 2013 financial performance for the following five competitive product groupings: (1) competitive domestic products with rates of general applicability; (2) competitive domestic products consisting of negotiated service agreements;[4] (3) competitive international products with rates of general applicability; (4) competitive international products consisting of negotiated service agreements; and (5) competitive nonpostal services.

Competitive Domestic Products with Rates of General Applicability

In FY 2013, there were 12 competitive domestic products with rates of general applicability. Those products were: (1) Priority Mail Express; (2) Priority Mail; (3) Parcel Select; (4) Parcel Return Service; (5) First-Class Package Service; (6) Standard Post;[5] (7) Address Enhancement Service; (8) Greeting Cards and Stationery; (9) Competitive Ancillary Services; (10) Premium Forwarding Service; (11) Post Office Box Service; and (12) Shipping and Mailing Supplies.

In FY 2013, each competitive domestic product with rates of general applicability generated sufficient revenues to cover attributable costs. Collectively, all 12 products generated $11.5 billion in revenues, and incurred $8.6 billion in costs. Thus, the products had an aggregate contribution of $2.9 billion. *See* PRC Financial Analysis Report, FY 2013. The Commission finds that each competitive domestic product with rates of general applicability complied with section 3633(a)(2).

In the FY 2013 ACR, Parcel Select's cost coverage appeared to be less than 100 percent and inconsistent with section 3633(a)(2). FY 2013 ACR at 48. However, the Postal Service's investigation into a possible revenue understatement revealed that Parcel Select's cost coverage exceeded 100 percent in FY 2013.[6]

[3] The Public Representative also concludes that competitive products revenues exceed the FY 2013 hybrid incremental costs. PR Comments at 45-46.

[4] Negotiated service agreement means a written contract, to be in effect for a defined period of time, between the Postal Service and a mailer, which provides for customer-specific rates or fees and/or terms of service in accordance with the terms and conditions of the contract. *See* 39 CFR 3001.5(r).

[5] Standard Post was a new competitive domestic product with rates of general applicability offered in FY 2013. *See* Docket No. MC2012-13, Order Conditionally Granting Request to Transfer Parcel Post to the Competitive Product List, July 20, 2012 (Order No. 1411). *See also* Docket No. CP2013-3, Order Approving Changes in Rates of General Applicability for Competitive Products, November 8, 2012 at 4 (renaming the product Standard Post). (Order No. 1536).

[6] *See* Notice of the United States Postal Service of Revisions to the FY 2013 Annual Compliance Report – Errata, February 6, 2014.

Competitive Domestic Products Consisting of Negotiated Service Agreements

In FY 2013, there were 112 competitive domestic products consisting of negotiated service agreements (NSAs). Table IV-1 displays the 112 products by selected product groupings.

Table IV-1
Competitive Domestic NSA Products in Effect During FY 2013

Competitive Domestic NSA Product Groupings	Number of Products[1]
First-Class Package Service Contracts	34
Parcel Return Service Contracts	3
Parcel Select & Parcel Return Service Contracts	1
Parcel Select Contracts	7
Priority Mail - Non-Published Rates[2]	1
Priority Mail & First-Class Package Service Contracts	1
Priority Mail Contracts	45
Priority Mail Express & Priority Mail Contracts	9
Priority Mail Express Contracts	10
Priority Mail Express, Priority Mail, & First-Class Package Service Contracts	1
Total	**112**

Source: Library Reference USPS-FY13-NP27; Responses to CHIR No. 2, question 2 and CHIR No. 5 question 12.

[1] With the exception of NSAs entered into under the Priority Mail - Non-Published Rates (NPR) product, each competitive domestic NSA is a separate product.

[2] The Priority Mail - NPR product allows the Postal Service to enter into Priority Mail NSAs without filing the agreements with the Commission for pre-implementation review. There were six Priority Mail - NPR NSAs in effect for FY 2013. *See* Docket Nos. MC2011-15/CP2011-51.

Pursuant to section 3633(a)(2), each domestic competitive NSA product must cover its attributable costs. The Commission finds that with the exception of Parcel Return Service Contract 4, each competitive domestic NSA product for which the Postal Service filed contract-specific data covered its attributable costs and complied with the statutory requirements of section 3633(a)(2). However, as discussed below under Competitive Domestic NSA Reporting Issues, the Commission was unable to make a definitive finding on 33 of the 34 First-Class Package Service NSA products because the Postal Service did not file contract-specific financial data for the products.

Parcel Return Service Contract 4

Parcel Return Service Contract 4 did not generate sufficient revenues to cover attributable costs in FY 2013. This contract was a new type of Parcel Return Service contract that was offered in FY 2013 known as Parcel Return Service Full Network NSAs. For Parcel Return Service Full Network NSAs, the Postal Service returns contract pieces to the customer's facility instead of a Postal Service facility (*e.g.*, a delivery unit or a network distribution center).

The cost model for Parcel Return Service Full Network NSAs uses Parcel Select Non-Presort as a proxy for transportation costs. The Postal Service explains that the increase in the contract's attributable costs is due primarily to increases in the costs for heavyweight non-NSA Parcel Select, particularly in Parcel Select Non-Presort.[7] When Parcel Return Service Contract 4 was originally filed, the average size and weight of Parcel Select Non-Presort was approximately equivalent to the customer's parcels. The Postal Service also explains that it is likely that some low-volume commercial Parcel Post pieces migrated to Parcel Select. *Id.* It indicates that these migrated pieces are heavier than the average Parcel Select pieces, and, because they are not dropshipped, travel further distances on the transportation network. *Id.*

Public Representative Comments

The Public Representative notes that Parcel Return Service Contract 4 did not cover costs in FY 2013. PR Comments at 51-52. He observes that Parcel Select Contract 4 is a 3-year contract with more than 2 years remaining in the contract. Consequently, the Public Representative recommends that the Commission direct the Postal Service to cancel the contract in accordance with Section 3 of the contract, which allows the Postal Service to cancel the contract with 30 days' notice to its contracting partner. *Id.* at 52.

In response to the Public Representative, the Postal Service asserts that cancellation of Parcel Return Service Contract 4 is not warranted under the circumstances. Postal Service Reply Comments at 6.[8] The Postal Service explains that the root of this contract's cost coverage problem is the use of Parcel Select Non-Presort as a proxy, which was reasonable when approved, but has become less appropriate because the size characteristics of the proxy category have changed. *Id.* The Postal Service explains that reasonable adjustments to the contract's costing model will demonstrate that revenues from the product can be expected to cover costs in future years. *Id.*

Commission Analysis

Based on the reported financial data, the Commission finds that the Parcel Return Service Contract 4 appears to not have complied with section 3633(a)(2) in FY 2013. The Commission accepts the Postal Service's explanation that the reported FY 2013 attributable costs for Parcel Return Service Contract 4 do not accurately reflect the contract partner's attributable costs and that the costing methodology for this contract should be revised to allow for adjustments to better reflect the contract partner's mailpieces. The Postal Service states that it will request a rulemaking to change the cost methodology for this contract. *Id.*

The Commission directs the Postal Service to develop a revised costing methodology that can be used for this contract and future Parcel Return Service Full Network contracts. The Postal Service should file the proposed methodology in a rulemaking proceeding within 90 days of the issuance of the FY 2013 ACD. If Parcel Return Service Contract 4 does not cover costs under the revised costing methodology, within 90

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[7] Response to CHIR No. 2, question 2.

[8] *See also* Response to CHIR No. 5, question 11.

days of the Commission's decision on the proposed methodology, the Postal Service will have to revise the terms of, or terminate, the contract.

Competitive Domestic NSA Reporting Issues

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 CFR 3050.21(g)(2). With the exception of 33 First-Class Package Service NSA products, the Postal Service provided total volume, revenue, and cost data for each competitive domestic NSA product that was in effect during FY 2013.[9]

The Postal Service noted that 33 of the 34 First-Class Package Service contracts in effect during FY 2013 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. 2, question 2. 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, these types of First-Class Package Service contracts are no longer required. *Id.*

For those reasons, the Postal Service did not track these 33 First-Class Package Service NSA products. *Id.* In lieu of providing contract-specific financial data for these 33 First-Class Package Service NSA products, the Postal Service provided a workbook summarizing costs for all First-Class Package Service NSAs. *Id.*; *see also* Library Reference USPS-FY13-NP32.

The Commission recognizes the unique position of these First-Class Package Service NSA products and accepts the Postal Service's rationale for reporting the financial data for these products with the First-Class Package Service product in this limited instance. However, the Commission must review each NSA product 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 product, regardless of its rationale for treating the product as an NSA, or request a waiver prior to deciding not to collect data.*

Since the Postal Service did not file contract-specific data for these 33 First-Class Package Service NSA products, the Commission cannot make a definitive finding pursuant to section 3633(a)(2) for these products. However, since each of the underlying 33 First-Class Package Service contracts paid published prices and those prices are found to satisfy section 3633(a)(2) in FY 2013, it is likely that each of these 33 First-Class Package Service NSA products also satisfied section 3633(a)(2) in FY 2013.

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[9] In response to CHIR No. 5, question 12, the Postal Service discusses 24 additional, non-First-Class Package Services NSA products for which it did not provide financial data. It notes that 21 of the 24 products had no mailpieces shipped under the respective contracts in FY 2013. It further notes that contracts for the remaining three products were only in effect for less than 1 month during FY 2013 and that the mailers had another contract in effect for the rest of 2013. Consequently, for those three products, the Postal Service provided the financial data with the corresponding contract with the same mailer that was in effect for 11 months in FY 2013.

Competitive International Products with Rates of General Applicability

Competitive international mail consists of 10 products featuring rates and fees of general applicability.[10] These products are: (1) Outbound International Expedited Services; (2) Outbound Priority Mail International; (3) Inbound Air Parcel Post (at UPU rates); (4) Outbound Single-Piece First-Class Package International Service; (5) International Surface AirLift; (6) International Priority Airmail; (7) International Direct Sacks-M-Bags; (8) International Money Transfer Service-Outbound; (9) International Money Transfer Service-Inbound; and (10) International Ancillary Services.[11]

For FY 2013, the Commission concludes that each of the above-referenced competitive international mail products, with the exception of International Priority Airmail (IPA) and International Money Transfer Service (IMTS)-Outbound, satisfies the requirements of section 3633(a)(2).[12] There is insufficient information to permit the Commission to determine whether the International Money Transfer Service (IMTS)-Inbound product satisfies section 3633(a)(2).[13]

International Priority Airmail

The IPA product reported a loss in FY 2013, resulting in a substantial decrease in the cost coverage compared to FY 2012. The decrease reflects both a 4.2 percent decrease in unit revenue and a 103.8 percent increase in unit attributable cost between FY 2012 and FY 2013. Unit contribution decreased 240.3 percent.

The Postal Service explains that it "continues to consider possible causes" for the decrease in the IPA product cost coverage compared to FY 2012, and that "identifying specific causes with small revenue-reporting products is often difficult on a year-to-year basis." FY 2013 ACR at 48. The Postal Service also states that it "continues to work on compensatory pricing for this small volume" product. Response to CHIR No. 6, question 5.

Nearly 97.7 percent of all IPA mail volume is entered through Global Plus Contracts, specifically, the Global Plus 1C and 2C products, which consist of NSAs. Postal Service Reply Comments at 7, n.21. The remaining 2.3 percent of IPA mail volume that is not entered through an NSA is reported as volume for the IPA product. There are no direct In-Office Cost System (IOCS) cost tallies of the IPA product volume.

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[10] Rates and fees of general applicability in effect during FY 2013 for competitive international mail products were established pursuant to Order No. 1062. 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); and Order No. 1536, Docket No. CP2013-3, Order No. 1536, Order Approving Changes in Rates of General Applicability for Competitive Products, November 8, 2012 (implemented January 27, 2013).

[11] 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).

[12] 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 thePostal 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 RPW report.

[13] As revenues for the IMTS-Inbound product are de minimus, the Commission is not pursuing development of cost and volume data in this ACD.

According to the Postal Service, total IPA attributable costs are initially estimated for IPA volumes as a whole, i.e., both Global Plus NSA and non-NSA volumes. Attributable costs are then calculated for the NSAs and subtracted from the estimate of total IPA costs. Response to CHIR No. 3, question 11. The residual, i.e., total IPA attributable costs less NSA attributable costs, becomes the cost reported in the ICRA for the IPA product. *Id.* The Postal Service concludes that "any variance in the estimate of costs for NSAs that are part of Global Plus Contracts will have a magnified effect on the residual costs" of the IPA product.[14]

The Commission is skeptical that variance alone is the cause of the FY 2013 loss. IPA product costs are comprised predominantly of settlement charges and international air transportation, including transit and internal air conveyance charges. These costs account for nearly 90 percent of the total attributable product costs and are calculated using known rates and volumes.[15] Any statistical variance caused by IOCS or TRACS sampling errors only affects slightly more than 10 percent of the IPA product's attributable costs. Thus, the source of the substantial reduction in unit attributable cost for the IPA product in FY 2013 likely lies elsewhere.

Public Representative Comments

The Public Representative is the only party to comment on the IPA product. While acknowledging the challenges identified by the Postal Service in assessing the causes of the decrease in cost coverage for this small-volume product, the Public Representative finds the Postal Service's definition of IPA "parent product" costs in its explanation confusing, and the methodology for calculating IPA costs undeveloped.[16] The Public Representative also notes that unit revenue decreased in FY 2013 compared to FY 2012, and this is of "particular concern" because of the 2.4 percent average decrease in IPA prices that became effective in FY 2014. As a result, the current "IPA prices are lower than those that failed to cover costs in FY 2013." PR Comments at 48.

The Public Representative concludes that the IPA product does not comply with section 3633(a)(2) and recommends that the Commission order the Postal Service to further investigate the FY 2013 decrease in unit revenue and increase in costs. *Id.* The Public Representative also suggests that the Commission request the Postal Service improve its methodology for calculating IPA costs. *Id.* Finally, it recommends that the Commission assess whether an increase in rates for the IPA product is necessary, in light of the 2.4 percent average decrease in IPA rates for FY 2014. *Id.*

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[14] *Id.* In its Reply Comments, the Postal Service concludes that "the initial estimate of 'total' IPA costs is overwhelmingly driven by NSA pieces, and the remaining non-NSA [i.e., the IPA product] part is very difficult to capture for costing purposes." Postal Service Reply Comments at 7, n.21. The Postal Service also cites a "gross to net weight issue" that impacts IPA product costs. Specifically, "NSA data are net weight and the RPW [presents] gross weight, which is used to cost the flows for the residual products." Response to CHIR No. 6, question 5.

[15] Library Reference USPS-FY13-NP2 (Revised 2-6-14), Excel file Reports (Booked).xls, worksheet tab B Pages (c).

[16] PR Comments at 48. In its Reply Comments, the Postal Service seeks to clarify its Response to CHIR No. 3, question 11, which prompted the Public Representative's concerns, in an extended footnote providing additional information on the development of costs for the IPA product. Postal Service Reply Comments at 7, n.21.

Commission Analysis

The Commission finds that the IPA product does not comply with section 3633(a)(2). The Commission therefore directs that the Postal Service report within 90 days and reconfirm that the IPA product will cover the projected attributable costs in FY 2014. The Postal Service shall also provide an analysis of the causes of the FY 2013 loss and decrease in cost coverage. In addition, the Postal Service is to recommend modifications to its current methodology of developing costs and, if necessary, propose the modifications in a rulemaking, so as to improve the reliability of such costs for the IPA product.

International Money Transfer Service—Outbound

Revenues for the IMTS-Outbound product were less than its attributable costs in FY 2013. According to the Postal Service, the "main change" between FY 2013 and FY 2012 was a 96 percent decrease in Outstanding MO [Money Orders] Taken Into Revenue. Response to CHIR No. 5, question 5(a). No explanation as to the cause(s) prompting this substantial decrease is provided.

Public Representative Comments

The Public Representative discusses the IMTS-Outbound and IMTS-Inbound products together. He notes the FY 2013 loss for the IMTS-Outbound product and the absence of transaction volumes and costs for the IMTS-Inbound product, which "once again" precludes the Commission from assessing whether the product complies with section 3633(a)(2). PR Comments at 49. The Public Representative recommends that the Commission take further steps to ensure it has the necessary information to evaluate cost coverage for the IMTS-Outbound and IMTS-Inbound products. *Id.* He also recommends that the Commission consider whether rate increases are necessary for both products. *Id.*

Commission Analysis

For International Money Transfer Service-Outbound , the Commission finds that in FY 2013, this product does not comply with section 3633(a)(2). In recent years, the IMTS-Outbound product has generated revenues in excess of its attributable costs. Accordingly, the Commission considers remedial price increases at this time to be premature. However, given the absence of information on the causes of the loss for the IMTS-Outbound product, *the Commission directs that the Postal Service report within 90 days on the causes of the FY 2013 loss and its plan to improve the financial results of the IMTS-Outbound product such that revenues exceed attributable costs.*

Competitive International Products Consisting of Negotiated Service Agreements

Competitive international mail also includes products with rates and fees established pursuant to one or more NSAs. These 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.

The Commission evaluates each competitive international product 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. The grouping of functionally equivalent NSAs was permitted to address administrative concerns involving product reporting and classification on the competitive product list.

Such functionally equivalent international NSAs are collectively evaluated as a product for consistency with section 3633(a)(2). Each NSA within a product grouping must also cover its attributable costs.

To that end, the MCS specifically requires that the revenue for each international NSA, grouped by product under the organizational categories, cover 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.[17] 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.[18]

The Postal Service reports financial results for competitive outbound and inbound international products consisting of NSAs. It also reports volume, revenue, and cost data on each competitive outbound and inbound international NSA. For FY 2013, the Postal Service provides such data for 297 international NSAs, of which 276 feature negotiated rates for outbound mail and 21 feature negotiated rates for inbound mail. The financial results for competitive outbound and inbound international products consisting of NSAs that do not cover costs are discussed separately below.

Competitive Outbound International Products Consisting of NSAs

For FY 2013, the Postal Service reports financial results for all products in Table IV-2 under the column heading, Product Name. *The Commission concludes that in FY 2013, the referenced competitive outbound international products consisting of NSAs provide contribution to the institutional costs of the Postal Service and therefore satisfy the requirements of section 3633(a)(2).*

The FY 2013 financial results for each outbound NSA in these products show that 275 of the 276 NSAs generated sufficient revenues to cover their attributable costs. The one NSA for which revenue did not cover attributable costs is in the Global Plus 2C product.

[17] *See* MCS sections 2515.6, 2515.4, 2515.5, and 2515.3.

[18] *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; and 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.

Table IV-2
FY 2013
Competitive Outbound International Products
Grouped by Product Category

Product Category	Product Name
Global Bulk Economy Contracts	(Same)
Global Direct Contracts	Global Direct Contracts 1
Global Expedited Package Services Contracts	GEPS 3
Global Expedited Package Services—Non-Published Rates	GEPS—NPR 2
	GEPS—NPR 3
	GEPS—NPR 4
Global Plus Contracts	Global Plus 1C
	Global Plus 2C
Global Reseller Expedited Package Contracts	GREPS 1
	GREPS 2
Priority Mail International Regional Rate Boxes—Non-Published Rates	(Same)

Global Plus 2C

The Global Plus 2C product offers volume-based rates through NSAs 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).

For FY 2013, the Global Plus 2C product, which is comprised of two NSAs, generated sufficient revenues as a whole to cover collective attributable costs. However, one NSA (the subject of Docket No. CP2012-10) spanned portions of two consecutive fiscal years: Quarters 2 – 4 (January through September, 2012) of FY 2012 and Quarter 1 (October through December, 2012) of FY 2013. The reported financial results for Quarter 1 of FY 2013 represent a continuation of quarterly losses in FY 2012 for this NSA.[19] Therefore, the Commission finds that the Docket No. CP2012-10 NSA does not satisfy section 3633(a)(2). Because this NSA terminated during FY 2013, no remedial action is required.

[19] *See* FY 2012 ACD at 169 for a discussion of losses incurred in Quarters 2 – 4 of FY 2012 for Docket No. CP2012-10 NSA.

Competitive Inbound International Products Consisting of NSAs

Like competitive outbound international products, competitive inbound international products featuring negotiated rates are classified on the competitive product list under several categories. Table IV-3 below shows the competitive inbound international products organized by product category. As with competitive outbound international products, sometimes the product category is also the name of the competitive inbound international product.

Table IV-3
FY 2013
Competitive Inbound International Products
Grouped by Product Category

Product Category	Product Name
International Business Reply Service Competitive Contracts	
	International Business Reply Service Competitive Contracts 1
	International Business Reply Service Competitive Contracts 3
Inbound Direct Entry Contracts with Customers	(Same)
Inbound Direct Entry Contracts with Foreign Postal Administrations	
	Inbound Direct Entry Contracts with Foreign Postal Administrations
	Inbound Direct Entry Contracts with Foreign Postal Administrations 1
Inbound International Expedited Services	
	Inbound International Expedited Services 2
Inbound Air Parcel Post (at non-UPU rates)	
	Royal Mail Group Inbound Air Parcel Post Agreement
Inbound Competitive Multi-Service Agreements with Foreign Postal Operators 1	(Same)

For FY 2013, the Postal Service reports financial results for seven of the eight listed products in Table IV-3. No data are reported for Inbound Direct Entry Contracts with Customers. Of the seven active products, one does not satisfy the requirements of section 3633(a)(2), *namely, Inbound Air Parcel Post (at non-UPU rates).* The Postal Service also reports financial results for each of the 21 NSAs within these products. *One NSA, with the China Post Group, which is part of Inbound Competitive Multi -Service Agreements with Foreign Postal Operators, does not satisfy 3633(a)(2).* Each of these is discussed below.

Inbound Air Parcel Post (at non-UPU rates)

For the Inbound Air Parcel Post (at non-UPU rates) product, the Postal Service reports financial results for inbound air parcels from Royal Mail and collectively from several other European postal operators that are parties to the Agreement for the Delivery of Day-Certain Cross-Border Parcels (EPG agreement). Inbound Air Parcel Post from Royal Mail is entered pursuant to the Royal Mail Inbound

Air Parcel Post Agreement, which is classified as a product on the competitive product list. Bilateral agreements for the entry of inbound air parcels from postal operators of the EPG-member countries of Belgium, Denmark, Germany, Finland, Sweden, Switzerland, Slovakia, and Slovenia were executed prior to the PAEA. FY 2013 ACR at 49. These agreements are not included on the competitive product list. *Id.*

For FY 2013, the Postal Service reports a loss for Inbound Air Parcel Post (at non-UPU rates) under the booked version of the ICRA, and a positive contribution to institutional cost under the imputed version.[20] *Id.* Revenue from inbound air parcels entered pursuant to the bilateral agreement with Royal Mail exceeded attributable costs. As a result, the loss is caused solely by the financial results for inbound air parcels from EPG-member countries. The Postal Service states that "inbound rates for EPG air parcels tendered by [EPG-member] posts have not changed." *Id.*

The Commission notes that under the booked version of the ICRA the FY 2013 loss is substantially less than the FY 2012 loss. In response to the FY 2012 loss, the Commission directed the Postal Service to 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. FY 2012 ACD at 172.

The Postal Service's response to this directive informed the Commission of its implementation of a "performance action plan" for EPG parcels.[21] That plan, designed to decrease penalty payments and increase revenue, included renovations to International Service Centers (ISCs), installation of additional sorting equipment, and consolidation of military mail operations at one ISC. *Id*. In addition, postal management set quarterly on-time service performance goals, and worked with each ISC to address unique issues and achieve improved performance. *Id.* While the Postal Service is not able to directly link any of these initiatives with reduced penalties and increased revenues, it observes that on-time delivery performance improved nearly 30 percent from October 2012 to October 2013, which reduces the number of EPG parcels subject to penalty payments. *Id.*

Public Representative Comments

The Public Representative notes that the cost coverage for the Inbound Air Parcel Post (at non-UPU rates) product improved dramatically in FY 2013, which "indicates that the Postal Service has made some of the changes necessary" so that revenues cover costs. PR Comments at 51. The Public Representative recommends that the Commission continue to monitor the progress of the Inbound Air Parcel Post (at non-UPU rates) product. *Id.*

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[20] Booked Expenses are the reported costs contained in the Postal Service's trial balance for settlement payments. Imputed expenses for settlement payments are calculated using the known rate for each country multiplied by the known units (number of pieces or pounds of mail or both depending on the formula that applies for each country).

[21] Docket No. ACR2012, Responses of the United States Postal Service to Commission Requests for Additional Information in FY 2012 Annual Compliance Determination, June 26, 2013, question 4. The Postal Service subsequently refers to this plan as the "EPG continuous improvement plan." Response to CHIR No. 5, question 3(a).

Commission Analysis

As noted above, current rates applicable to inbound air parcels from EPG member countries have not changed, in some cases for many years, and in FY 2013 revenues again failed to cover attributable costs. Such inbound air parcels rates appear to be inconsistent with U.S. postal policy, which is designed 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 problematic. 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.

The Commission concludes that Inbound Air Parcel Post (at non-UPU rates) does not comply with sections 407(a)(2) and 3633(a)(2). Nevertheless, the Commission recognizes the substantial improvement in the FY 2013 financial results compared to FY 2012, and the improvement in on-time performance achieved through the EPG continuous improvement plan. The Commission therefore directs the Postal Service to pursue additional improvements in on-time performance through implementation of the EPG continuous improvement plan so as to improve the financial results for Inbound Air Parcel Post (at non-UPU rates) during FY 2014. In addition, the Commission directs the Postal Service to negotiate bilateral NSAs governing the entry of inbound air parcel with EPG-member countries so as to add such NSAs to the competitive product list.

Inbound Competitive Multi-Service Agreements with Foreign Postal Operators 1

The Inbound Competitive Multi-Service Agreements product consists of a number of bilateral NSAs with seven foreign postal operators for the entry of Inbound Express Mail Service (EMS), Inbound Air Parcel Post (ACP) and Inbound Surface Parcel Post (SCP) items.

For FY 2013, the Postal Service reports that the Inbound Competitive Multi-Service Agreements product as a whole generated sufficient revenues to cover collective attributable costs. However, one NSA with the China Post Group, which was the subject of Docket No. CP2011-68, spanned portions of two consecutive fiscal years: Quarters 2 – 4 (January through September, 2012) of FY 2012 and Quarter 1 (October through December, 2012) of FY 2013. The reported financial results for Quarter 1 of FY 2013 represent a continuation of quarterly losses in FY 2012 for this NSA. *The Commission therefore finds that the Docket No. CP2011-68 NSA does not satisfy section 3633(a)(2). No remedial action is required because this NSA terminated in FY 2013.*

Nonpostal Services

In FY 2013, nonpostal services[22] generated $94.6 million in revenue and incurred $32.0 million in expenses, which resulted in a net income of $62.6 million in FY 2013. This figure represents a 25 percent decrease compared to FY 2012.

[22] 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. Docket No. MC2010-24, Order 1575, Order Approving Mail Classification Schedule Descriptions and Prices for Nonpostal Service Products, December 11, 2012, at 4.

The non-public financial data show that two products, the USPS Electronic Postmark (EPM) program and the Officially Licensed Retail Products (OLRP), failed to generate sufficient revenues to cover expenses. *See* Library Reference USPS-FY13-NP27. In FY 2013, the Postal Service permanently discontinued the EPM Program. *See* FY 2012 ACD and Response to CHIR No. 5, question 11. In FY 2013 the Postal Service incurred expenses in continuing to provide EPM verification services related to a third party contract.[23]

The Postal Service in its Response to CHIR No. 5, question 8 stated that the FY 2012 OLRP inventory of digital postage scales, passport holders, stamp coil dispensers and Click-N-Ship Shipping Labels were low. Purchases intended to be made in late FY 2012 were delayed until FY 2013 causing the inventory expenses to be booked in FY 2013. This resulted in higher inventory costs in FY 2013 causing OLRP products to fail to cover costs in the current year. In FY 2014, the Postal Service expects OLRP products to replicate their historically positive cost coverage with no likelihood of a recurrence of the FY 2013 inventory timing issues. *Id.*

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 has determined that if competitive products contribute at least 5.5 percent toward the Postal Service's total institutional costs, then competitive products, as a whole, cover an appropriate share of the Postal Service's total institutional costs. *See* 39 CFR 3015.7(c).[24]

In FY 2013, the Postal Service reported that total institutional costs were $33.1 billion.[25] Therefore, in order to comply with section 3633(a)(3) for FY 2013, competitive products must contribute at least $1.8 billion toward the Postal Service's institutional costs. In FY 2013, the total competitive products contribution was $3.9 billion (or 11.7 percent of institutional costs), which exceeds the $1.8 billion minimum contribution requirement.[26]

Therefore, the Commission finds that in FY 2013 competitive products satisfied section 3633(a)(3) by covering an appropriate share of the Postal Service's institutional costs.

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[23] In Library Reference USPS-FY12-NP27 the Postal Service stated that EPM incurred expenses related to a third party contract to provide EPM verification service for 7 years to customers that have already purchased EPMs. Order No. 1575, Appendix B at 13 describes EPM as a program allowing 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 had not been altered.

[24] 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. *See* Docket No. RM2012-3, Order Reviewing Competitive Products' Appropriate Share Contribution to Institutional Costs, August 23, 2012, at 24-25 (Order No. 1449).

[25] Library Reference USPS-FY13-1 (revised February 6, 2014).

[26] The Public Representative also concludes that the Postal Service complied with section 3633(a)(3) in FY 2013. *See* PR Comments at 52.

ISSUES RAISED BY COMMENTERS

In its initial comments, United Parcel Service (UPS) raises three issues with competitive products.[27] These issues are: (1) the attribution of total postal costs; (2) the appropriate share of institutional costs; and (3) access to non-public data. Although UPS contends that these issues are "relevant to the Commission's review," it recognizes that the issues before the Commission are limited primarily to whether the rates in effect in FY 2013 complied with the statute. *Id.* at 1. UPS urges the Commission to consider these matters in future proceedings where the issues can be examined in greater detail. *Id.* Each issue is discussed below.

Attribution of Total Postal Costs

UPS questions whether competitive products are "shouldering a fair and equitable share of total postal costs." *Id.* at 1. UPS states that it has these concerns because the total attributable costs, as a share of total postal costs, have fallen significantly since Docket No. R97-1.[28]

UPS contends that having a large amount of institutional costs creates the opportunity for the Postal Service "to avoid fiscal responsibility, to the detriment of itself, market dominant mailers and competitive products mailers, and competition, and is contrary to the PAEA." *Id.* at 4. UPS cites statements from the Postal Service that it believes raise questions about the accuracy of the current cost allocation methods for total postal costs. Specifically, UPS contends that statements from the Postal Service concerning its capital commitments and expenditures, including package sorting investments, and enhancements to scanning and tracking systems, suggest that the Postal Service is treating all such costs as institutional. *Id.* at 5-6. UPS believes that these statements indicate that the Postal Service is categorizing costs as institutional that are generated by competitive products. *Id.*

UPS encourages the Commission to accelerate its efforts to improve cost attribution and to find other ways to improve attributable costing as a whole in light of changes taken place since PAEA, including the transfer of many products from the market dominant product list to competitive product list. *Id.* at 6.

PostCom Reply

PostCom agrees with UPS that the Postal Service must do more to properly track the attributable costs of its products, both market dominant and competitive. PostCom Reply Comments at 1.[29] PostCom believes that with the current lack of accurate cost attribution, neither mailers nor the Commission can determine whether each competitive product is covering the costs attributable to it in accordance with section 3633(a)(2). *Id.* at 2. PostCom states that it defies belief that none of the capital expenditures engaged in by the Postal Service over the past three years could be attributed to particular products. *Id.* Like UPS, PostCom encourages the Commission to accelerate and expand its efforts to improve attributable costing. *Id.* at 3.

[27] Initial Comments of United Parcel Service on Postal Service's FY2013 Annual Compliance Report, January 31, 2014 (UPS Initial Comments).

[28] UPS states that the cost attribution percentage has dropped from 65.1 percent in the Docket No. R97-1 proceedings to 54.2 in FY 2013. *Id.* at 2.

[29] Docket No. ACR2013, Reply Comments of the Association for Postal Commerce, February, 14, 2014 (PostCom Reply Comments).

PostCom contends that the Postal Service should use IMb information and employ a bottom-up costing methodology to better understand cost drivers and allocate costs. *Id.* at 2. It asserts that bottom-up costing, when developed through IMb data, allows for more direct measurement of the activities performed in moving different types of mail through the system, from collection to delivery. *Id.* PostCom concludes that using a bottom-up approach would allow the Postal Service to price its products so that they cover their measured attributable costs. *Id.*

Postal Service Reply

The Postal Service contends that the decline in attributable costs, as a share of total costs, is due to massive volume declines, which reduce volume variable costs while leaving non-volume variable costs predominantly intact. Postal Service Reply Comments at 9. In addition, the Postal Service notes that total attributable costs have also fallen due to a substantial change in the mail mix from higher cost First-Class Mail pieces to lower cost Standard Mail pieces. *Id.*, n.25.

The Postal Service asserts that attributable costs have not fallen as dramatically as UPS claims. *Id.* at 11, n.27. It asserts that a comparison of the attributable cost share of Docket No. R2006-1 (55.4 percent) to FY 2013 (54.2 percent) shows only minimal decline.

The Postal Service counters UPS's suggestion that costs for capital expenditures are being improperly treated as entirely institutional by explaining that once capital commitments are converted to actual capital purchases, the resulting depreciation expenses are attributed to both market dominant and competitive products using established distribution methodologies. *Id.* at 10-11, n.26.

The Parcel Shippers Association Reply

PSA agrees with UPS that it is important to have accurate estimates of the cost of Postal Service products, and it supports measures that will improve cost attribution.[30] However, PSA states that the mere fact that attribution levels have declined does not prove that cost measurements are flawed. *Id.* at 2. It states that there is a reasonable explanation for the decline with respect to competitive products. *Id.* PSA notes that the declining attribution levels are natural consequences of declining volumes, and of delivery costs becoming a larger proportion of total Postal Service costs over time. *Id.* PSA explains that fixed costs constitute a larger share of delivery costs than they do of other large cost segments, such as mail processing and transportation. *Id.*[31]

PSA agrees with UPS that competitive products should be charged for capital equipment used in the provision of those products. *Id.* at 5. It believes that UPS's description of how capital costs are treated is incorrect. *Id.* at 6. Like the Postal Service, PSA explains that cost of capital equipment is allocated to both competitive and market dominant products through depreciation. *Id.* PSA contends that confusion with capital commitment expenditures is due to general confusion associated with the operation of the Competitive Products Fund. *Id.* PSA encourages the Commission to proceed quickly in Docket No. PI2013-1, to clarify the operation of the Competitive Product Fund. *Id.*

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[30] Reply Comments of the Parcel Shippers Association, February 14, 2014, at 1 (PSA Reply Comments).

[31] UPS also references the current Docket No. PI2013-1 proceeding before the Commission and states that there is no transparency in the statutorily mandated Competitive Products Fund. *See* UPS Initial Comments at 10, n.3.

Public Representative Reply

The Public Representative presents a chart showing that the institutional costs, as a share of total postal costs, have increased, on average, by 1.7 percent from FY 2007 to FY 2013. PR Reply Comments at 10-11. The Public Representative contends that this average annual increase in the institutional share supports UPS's claim that attributable costs as a percentage of total costs are falling. *Id.* at 10.

Commission Analysis

Accurately attributing postal costs to products is critical. However, as UPS acknowledges, this is an issue that is more appropriately addressed in a future proceeding where it can be examined in greater detail. *See* UPS Initial Comments at 1. As UPS acknowledges, the issues currently before the Commission are limited primarily to whether the rates in effect in FY 2013 were in compliance with the statute. *Id.*

The issues raised in the comments do not warrant initiation of a proceeding to investigate the methodology the Postal Service uses to attribute total postal costs at this time. As the Postal Service states in its reply comments, the proportion of attributable costs has not fallen as much as UPS indicates when one compares the FY 2013 proportion to the R2006-1 proportion (54.2 percent and 55.4 percent, respectively). *See* Postal Service Reply Comments at 11, n.27. Therefore, the basis for UPS's claim that the attribution methodology should be investigated due to declining attributable costs proportions is unconvincing.

Parties alleging that the attribution of total postal cost methodology is not reliable must suggest improvements in order to merit consideration. Interested parties may submit petitions to investigate the cost attribution methodology used to develop the Annual Compliance Report data. *See* 39 CFR 3050.11(a).

Appropriate Share of Institutional Costs

UPS asserts that the minimum contribution to institutional costs required of competitive products should be re-examined. UPS Initial Comments at 6. It contends that significant additions to the competitive products list, as well as significant increases in Competitive Product's relative share of total revenue indicate that the current minimum contribution is in substantial need of revision. *Id.* 6-7.

UPS believes that market dominant mailers are footing a larger share of total institutional costs than is equitable or appropriate. *Id.* at 7. UPS notes that with the price adjustments that took effect on January 26, 2014, market dominant prices went up 5.9 percent, while competitive products prices went up 2.4 percent. *Id.* Additionally, UPS states that while the Postal Service is significantly increasing prices for market dominant products, it is reducing services for these products. *Id.*

UPS elaborates that, on the contrary, while price increases for competitive products are minimal, the Postal Service is expanding the services that it offers for such products, for example, by offering Sunday delivery for an NSA partner and day-definite delivery and free insurance for Priority Mail. *Id.* at 8.

UPS recommends that the Commission initiate a proceeding to consider whether to reallocate institutional costs between market dominant and competitive products on a more equitable basis. *Id.* at 14.

Public Representative Reply

The Public Representative notes that the Commission re-examined and affirmed the 5.5 percent minimum contribution percentage requirement in Docket No. RM2012-3. PR Reply Comments at 12, n.13. The Public Representative states that the Commission's affirmation was partly based upon data which showed that the competitive products' share of institutional costs between FY 2007 and FY 2011 had not changed very much. *Id.* In order to evaluate UPS's claim that the 5.5 percentage minimum contribution requirement is too low, the Public Representative examined competitive products' contribution as a share of institutional costs since the PAEA was implemented. *Id*. at 11. He observes that there was a significant increase in the competitive products' contribution as a share of institutional costs to nearly 12 percent in FY 2013. *Id.* at 12-13. The Public Representative concludes that the Commission should open a rulemaking to consider more appropriate allocations of institutional costs between market-dominant and competitive products and to re-examine the appropriate required percentage contribution to institutional costs from competitive products. *Id*. at 13.

PSA Reply

In response to UPS's argument that the Postal Service increased competitive product prices by a smaller percentage than market dominant rates this year, PSA notes that while this is true for this year, competitive product rates of generally applicability have increased by more than the rate of inflation and average market dominant rate increases. PSA Reply Comments at 6.

PSA states that given the substantial increases that the Postal Service has implemented and the increases in competitive product contribution that have occurred since enactment of PAEA, it is evident that the Postal Service has appropriate incentives to increase competitive product contribution, and not reduce it. *Id.* at 7. PSA further notes that in view of actual experience, there is probably not a need for an appropriate share requirement at all. *Id.* at 8.

Commission Analysis

In Order No. 1449, the Commission reaffirmed that the appropriate minimum share of institutional costs to be borne by competitive products is 5.5 percent.[32] In that order, the Commission noted that the law permits it to initiate a proceeding to change the competitive products' minimum contribution requirement at any time. Order No. 1449 at 24. The Commission also noted that parties may petition the Commission to initiate a rulemaking proceeding if circumstances warrant. *Id.*

[32] *See* Docket No. RM2012-3, Order Reviewing Competitive Products' Appropriate Share Contribution to Institutional Costs, August 23, 2012 (Order No. 1449).

UPS is not suggesting that the Commission consider this matter during this proceeding.[33] The Commission is required by law to re-examine the appropriate share requirement again no later than 2017. 39 U.S.C. 3633(b). Parties may petition the Commission to initiate such a proceeding prior to 2017.

Access to Non-public Data

UPS asserts that there has been a "dramatic decline" in public transparency since the PAEA was adopted, which has made it difficult to determine the causes of, and solutions to, the declining attribution rate as a share of total Postal Service costs. UPS Initial Comments at 8-9. Specifically, UPS notes that the Postal Service files individual competitive products' costs and cost coverages, and the data underlying those figures, under seal. *Id.* at 9-10. It states that the only publicly filed information on competitive products' cost attribution is a single line item for all domestic competitive products in the Postal Service's Cost Segment and Components Report. *Id.* at 10; *see* Library Reference USPS-FY13-2 (Revised February 6, 2014).

UPS contends that a lack of public access to information is responsible for a noticeable decline in public participation on competitive products costing issues.[34] *Id.* at 11. It claims that deadlines set by the PAEA are so short that there is hardly enough time for a party to obtain, review, and analyze materials filed under seal to determine whether to participate in a docket. *Id.* at 12. UPS concludes that a lack of access to data effectively denies the public its right to participate in Commission proceedings involving competitive products and precludes it from contributing to the Commission's analysis of whether competitive products are in compliance with section 3633. *Id.* at 12-13.

In seeking non-public treatment for the materials that it files under seal, the Postal Service states that the designated materials consist of "commercial information concerning postal operations that under good business practice would not be disclosed publicly." FY 2013 ACR, Attachment Two at 2.[35] UPS contends that the Postal Service is not just any commercial enterprise, and asserts that the increased pricing flexibility of the PAEA requires increased public scrutiny. UPS Initial Comments at 10-11.

UPS also notes that the Commission has historically relied upon the contributions from members of the public to assist it in refining data collection methods and attribution methodologies. *Id.* at 13.[36] UPS urges the Commission to initiate a proceeding to determine what information and materials the Postal Service must file publicly. *Id.* at 14.

[33] Additionally, in Order No. 1449, the Commission observed that Section 3633(a) requires the Commission to set the appropriate share through "regulations." *Id.*

[34] Valpak similarly notes that fewer parties are filing comments in the annual compliance reviews and asks the Commission to consider whether these proceedings are serving the purpose for which they were intended by Congress. Valpak Direct Marketing Systems, Inc. and Valpak Dealers' Association, Inc. Reply Comments on the United States Postal Service FY 2013 Annual Compliance Report, February 18, 2014 (Valpak Reply Comments), at 1, n 1.

[35] *See* 39 U.S.C. 504(g)(1); 39 U.S.C. 410(c)(2); 5 U.S.C. 552(b)(3).

[36] *See, e.g.*, Docket No. 2006-1, Opinion and Recommendation, Vol. 1 (February 26, 2007) at 21-54, 77-79.

PSA Reply

In its reply comments, PSA asserts that the Commission rules, which combine substantial disclosure of competitive product information under seal with more limited public disclosure, strike an appropriate balance between disclosure and oversight. PSA Reply Comments at 5. PSA contends that UPS' claims that the Postal Service withholds "almost all competitive product data from the public" and that "the public has no access to the information needed" to determine whether to participate in proceedings are overstated. *Id.* at 4. PSA notes that while the Postal Service does not provide attributable costs by cost segment and component for individual competitive products in the ACD, it does present substantial public information allowing interested parties to evaluate the accuracy of its costing methods in the summary description that it files annually with the Commission. *Id.* PSA notes that interested parties are free to petition the Commission to initiate rulemakings to improve costing methods or to request that the Commission change its disclosure rules. *Id.* at 5. However, it asserts that any petition to change the disclosure rules should not only describe the information to be disclosed, but also demonstrate that publicly traded companies are required to disclose the same or similar information. *Id.*

Postal Service Reply

The Postal Service contends that Commission procedures for protecting commercially-sensitive information and efforts at improving cost attribution are two disparate issues that should play no role in the Commission's annual compliance determination. Postal Service Reply Comments at 12. It notes that efforts to improve cost attribution occur in rulemaking proceedings, for which the PAEA imposes no tight deadlines. *Id.* at 11-12. The Postal Service notes that private parties may participate in such proceedings. It states that private parties could, if necessary, obtain access to any data that is shielded for commercial purposes, subject to protective conditions. *Id.*

Commission Analysis

UPS acknowledges that the issues currently before the Commission in this proceeding are limited primarily to whether the rates in effect in FY 2013 were in compliance with the statute. *Id.* at 1.

Commission rules concerning the protection of non-public information are intended to strike an appropriate balance between public access to information and the commercial interests of the Postal Service and its partners or customers.[37] Current rules permit parties to access non-public information subject to protective conditions. The Commission rejects the request to initiate a proceeding on the confidentiality rules at this time. However, as PSA points out, UPS is free to offer specific proposals to change the confidentiality rules. *See* 5 U.S.C. 553(e).

[37] *See* Docket No. RM2008-1, Order No. 194, Second Notice of Proposed Rulemaking to Establish a Procedure for According Appropriate Confidentiality, March 20, 2009.

CHAPTER 5

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 compares the information provided in the report against annual service performance targets established by the Postal Service to evaluate annual service performance for each market dominant product.[1]

First-Class Mail, Presorted Letters/Postcards met or exceeded annual service performance targets. Single-Piece Letters/Postcards, Flats, Parcels, Outbound Single-Piece First-Class Mail International, and Inbound Letter Post fell below targets. Standard Mail, High Density and Saturation Letters and Parcels met or exceeded annual service performance targets. High Density and Saturation Flats/Parcels, Carrier Route, Letters, and Flats fell below targets. Both Periodicals products, In-County Periodicals and Outside County Periodicals, showed significant improvement, but still did not meet annual service performance targets. Package Services, Bound Printed Matter Parcels and Media Mail/Library Mail met or exceeded annual service performance targets. Single-Piece Parcel Post (now Alaska Bypass Mail),[2] Bound Printed Matter Flats, and Inbound Surface Parcel Post (at UPU rates) fell below targets. All Special Services products met or exceeded annual service performance targets.

Three events affect the interpretation of service performance results in FY 2013: (1) the implementation of the Postal Service's Mail Processing Network Rationalization initiative; (2) changes to First-Class Mail service performance goals; and (3) continuing adoption of Full-Service Intelligent Mail barcode (IMb) service.

The Postal Service's Mail Processing Network Rationalization initiative resulted in nationwide changes to service standards for its market dominant products beginning in FY 2012 and continuing into FY 2013.[3] Most significantly for First-Class Mail, these changes included eliminating overnight service for inter-SCF mail, altering preparation requirements for presorted mail, and changing the eligibility for a 2-day service standard from mailpieces with a 12 hour or less drive time

[1] 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.

[2] Alaska Bypass Service was created when Single-Piece Parcel Post moved to the competitive product list.

[3] *See* Docket No. N2012-1, Advisory Opinion on Mail Processing Network Rationalization Service Changes, September 28, 2012.

between origin Processing and Distribution Center or Facilities and Area Distribution Centers to those with a drive time of six hours or less. The changes also increased the delivery day range for End-to-End Periodicals in the contiguous 48 states and revised the overnight service standard to exclude Periodicals entered at Network Distribution Centers and Auxiliary Service Facilities.[4]

In FY 2013, the Postal Service increased its annual service performance targets for domestic First-Class Mail.[5] The overnight target increased from 96.65 percent to 96.70 percent. The 2-day target increased from 94.15 percent to 95.10 percent. The 3-5-day target increased from 92.85 percent to 95.00 percent.

The Postal Service continued to emphasize the importance of Full-Service IMb participation. In FY 2013, there was steady improvement in the proportion of mail measured with an IMb for each class of market dominant mail.

Every two years, the Commission assesses a special study of final delivery service performance to the remote locations of the Alaska, Honolulu, and Caribbean Districts.[6] Since the special study was first conducted in FY 2011, the Postal Service has changed some service standards for Standard Mail, Periodicals Mail, and Package Services destinating to or originating from non-contiguous locations. Service performance results increased during the same time, likely as a result of the changes. The findings from the special study are discussed in Appendix B.

Participant Comments and Concerns on Service Performance

In FY 2013, one participant offered comments on service performance results for market dominant products. The Public Representative notes improved second quarter service performance results followed by a decline in the third and fourth quarters for Standard Mail products. He suggests this pattern is caused by seasonality and suggests the Postal Service should utilize its diagnostic capabilities to improve fourth quarter on-time delivery. PR Comments at 10. For Periodicals, he observes that most of the improvement in performance occurred in the second quarter which suggests, contrary to the Postal Service's conclusion, that the continuous diagnostic tool may not be responsible for the improvement. He concludes that the Commission should ask the Postal Service to explain why continuous use of the diagnostic system does not improve quarterly results in Periodicals. *Id.* at 11. Similarly, for Package Services, the Public Representative finds that the performance data do not support the Postal Service's claim that continuous use of its diagnostic tool improves performance. *Id.* at 12. Lastly, he asks the Postal Service to analyze the reasons Ancillary Services and PO Box Service reported declining results. He recommends the Postal Service take steps to improve these two Special Services products. *Id.* at 13.

[4] The Postal Service changed the delivery day range for End-to-End Periodicals from 1-9 days to 2-9 days. The 1-2-day delivery range for destination entry Periodicals changed to 1-3 days. *See* 77 FR 31192, 31195 (May 25, 2012).

[5] Rule 3055.5 requires the Postal Service to alert the Commission of any change in goals, targets, or standards with regard to service performance.

[6] *See* 39 CFR 3055.7.

MEASUREMENT SYSTEMS

The Postal Service uses a variety of measurement systems to measure service for each market dominant product. Table V-1 identifies each system used to measure those products reported in the Postal Service's Annual Service Performance Report.

Table V-1
Market Dominant Service Performance Measurement Systems

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

Source: Library Reference USPS-FY13-29; United States Postal Service, Service Performance Measurement, October 2007, at 6.

External First-Class Mail Measurement System (EXFC)

The EXFC is a sampling system managed by an independent contractor IBM. Delivery performance is measured from the street collection box to the delivery mailbox.[7] 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 respective mailboxes. Actual transit time is then compared against First-Class Mail service standards. The 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. In FY 2013, the SASP system captured data from all Full-Service Intelligent Mail.[8] 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.

[7] FY 2009 ACD at 49.

[8] Library Reference USPS-FY13-29 at 2.

Product Tracking System (PTS)

For use with parcels, PTS is an internal measurement system used by the Postal Service that 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 products.

Seamless Acceptance and Service Performance

The SASP system uses data provided by commercial mailers with Full-Service Intelligent Mail, such as acceptance time, payment, and verification, to enable the Postal Service to monitor service delivery and overall performance. Information collected also helps to determine address accuracy, verify mail preparation quality, and track individual pieces as they move through the mail system.

International Mail Measurement System (IMMS)

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

Intelligent Mail Barcode (IMb)

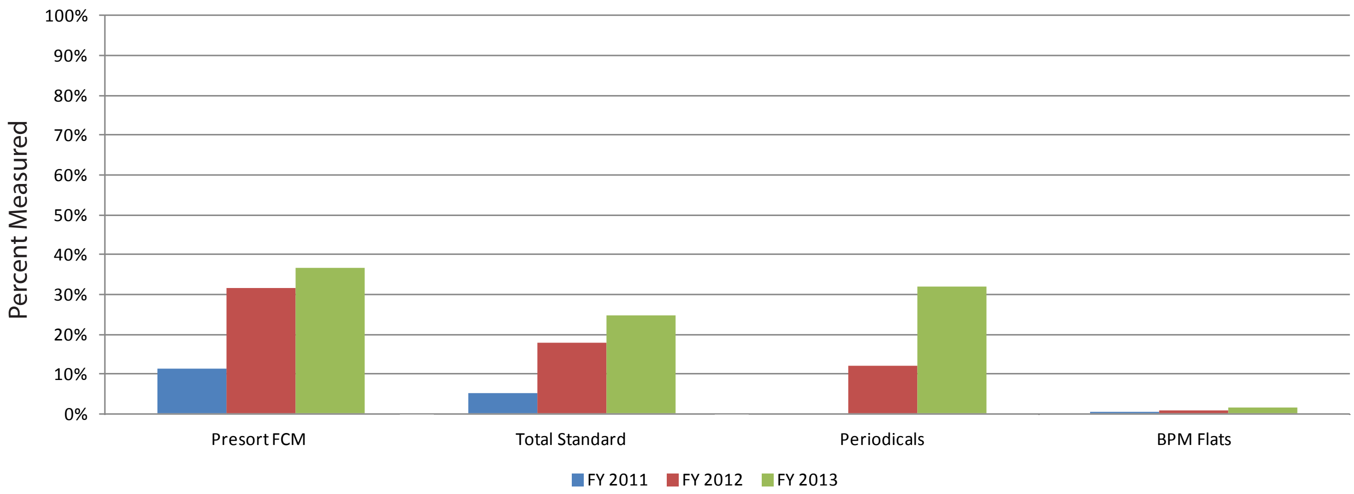
In quarter 3 of FY 2011, the Postal Service began measuring Standard Mail, Periodicals, Package Services, and some First-Class Mail products with the IMb. Mailers were encouraged to participate in the Full-Service option of IMb, in part, because it provides data necessary to measure service performance.[9] The Full-Service feature also allows the mailer to identify unique mailpieces throughout the mailstream and receive start-the-clock notifications, discounts, and automated address corrections.[10]

The Commission has been encouraging the Postal Service to increase IMb measurement across all product levels as it is generally positive for measuring and improving service performance. Since FY 2011, the number of mailpieces measured by the IMb has increased. Figure V-1 illustrates this trend by showing the percentage of presort First-Class Mail, Standard Mail, Periodicals, and Bound Printed Matter Flats volume measured by IMb that has increased since 2011.

[9] FY 2011 ACD at 63.

[10] *Id.*

Figure V-1
Percentage of Pieces Measured by Intelligent Mail Barcode



The Postal Service encountered problems in measuring service performance with the IMb despite the increases in pieces measured by it. For instance, the Postal Service stated that invalid or incomplete information used to identify Standard Mail products was provided by mailers, making it difficult to measure some Standard Mail at product levels. In FY 2012, the Postal Service included in its measurement Standard Mail pieces for which mailers did not supply enough information to identify the product. The Postal Service categorized this mail as either Standard Mail Mixed Product Letters or Standard Mail Mixed Product Flats.[11] In FY 2013, the volume of mail categorized as Mixed Product Letters and Flats declined considerably. Mixed Product Letters decreased from 1,500 million pieces in the first quarter to 135 million pieces in the fourth quarter. Mixed Product Flats decreased from 218.5 million pieces in the first quarter to 2.6 million pieces in the fourth quarter. The Postal Service states that in FY 2013, 19 percent of measurable Standard Mail letters and 5 percent of Full-Service Intelligent Mail Flats fell into these mixed product categories.[12]

The decrease in volume for Mixed Product categories suggests that more Standard Mail mailers are providing proper piece-level documentation. The increase in the volume of identifiable mailpieces helps to improve performance measurement accuracy for individual Standard Mail products.

The Postal Service acknowledges that measurable volumes for First-Class Mail Flats, Bound Printed Matter Flats, Standard Mail products, and DDU Entry Periodicals have been low since the onset of IMb measurement.[13] For some products, such as First-Class Mail Flats, proxies are used because of the low volumes measured at district levels.

[11] FY 2012 ACD at 54.

[12] Library Reference USPS-FY13-29.

[13] *Id.*

SERVICE PERFORMANCE RESULTS BY CLASS

First-Class Mail

In FY 2013, First-Class Mail represented 42.1 percent of total mail delivered versus 43.5 percent in FY 2012.[14] Presorted Letters/Postcards made up the largest proportion, accounting for 61 percent of the First-Class Mail volume. Service performance for Single-Piece Letters/Postcards and Presorted Letters/Postcards continued to exceed that of other products in First-Class Mail.[15] First-Class Mail Flats and Parcels continue to underperform and have not reached their 90 percent on-time delivery performance goals. *See* Table V-2.

Table V-2
Service Performance Results for First-Class Mail

	FY 2013		FY 2012		FY 2011	
	Target	Percent On-Time	Target	Percent On-Time	Target	Percent On-Time
Single-Piece Letters/Postcards						
Overnight	96.70	96.8	96.65	97.0	96.5	96.7
2-day	95.10	96	94.15	95.6	94.15	94.2
3-5-day	95.00	92.5	92.85	93.2	92.95	91.9
Presort Letters/Postcards						
Overnight	96.70	97.3	96.65	96.9	96.65	90.8
2-day	95.10	97.2	94.15	95.9	94.15	89.2
3-5-day	95.00	95.4	92.85	95.4	92.85	90.7
Flats						
Overnight	96.70	86.6	96.65	89.8	96.65	90.3
2-day	95.10	84.4	94.15	85.0	94.15	84
3-5-day	95.00	77.6	92.85	80.0	92.85	80
Parcels						
Overnight	96.70	89.8	96.65	89.8	96.65	90.3
2-day	95.10	89.1	94.15	85.8	94.15	83.2
3-5-day	95.00	88.8	92.85	88.4	92.85	86.6
Outbound Single-Piece First-Class Mail International						
Overnight	-	94.3				
2-day	-	92.7				
3-5-day	-	87.5				
Combined	94.00	88.9	94.00	91.5	94.00	91.9
Inbound Single-Piece First-Class Mail International						
Overnight	-	92.3				
2-day	-	90.7				
3-5-day	-	86.5				
Combined	94.00	88	94.00	90.5	94.00	91.9

Service performance results are reported using one decimal place while targets are reported using two decimal places. This captures the incremental increase in annual service performance targets.

*Numbers in red indicate service performance results that did not meet or exceed the annual service performance target.

[14] *See* PRC-FinRpt13-LR-1; Docket No. ACR2012, Library Reference PRC-ACR2012-LR1.

[15] Note that the Postal Service has increased the annual service performance targets for each domestic First-Class Mail product since FY 2011.

Comparisons between FY 2012 and FY 2013 service performance must be viewed in light of service standard changes associated with the Mail Processing Network Rationalization initiative. The initiative changed service standards by shifting much of the volume of mail previously subject to the overnight service standard to either the 2-day or 3-5-day service standard. It also changed service standards by shifting much of the volume of mail previously subject to the 2-day service standard to the 3-5-day service standard.

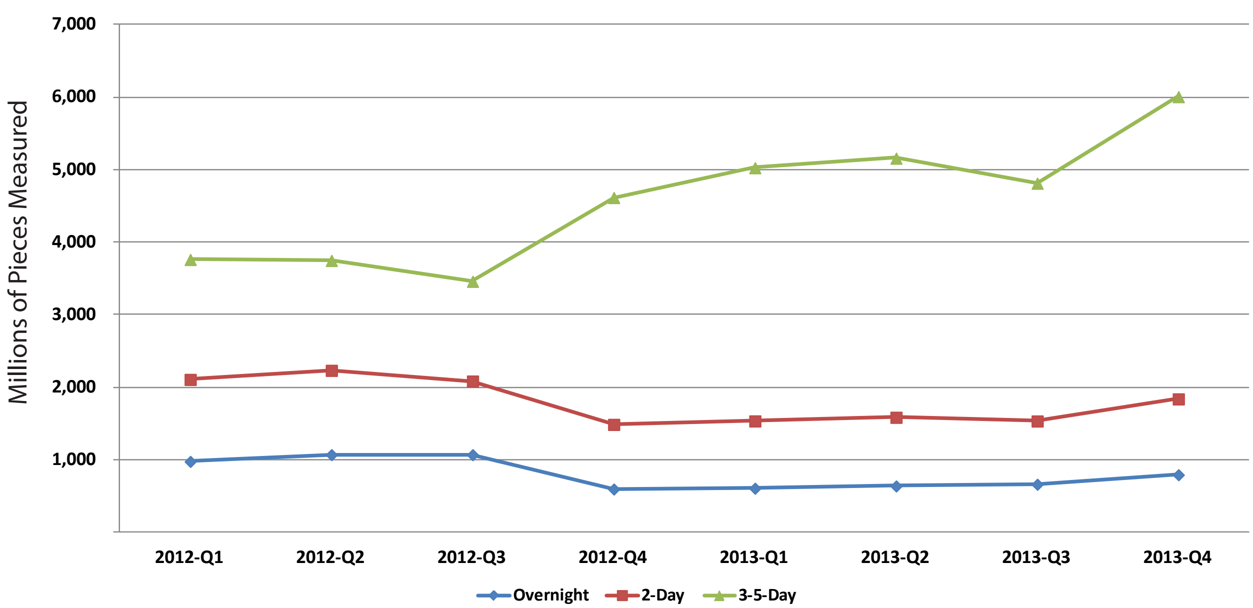
Single-Piece Letters/Postcards

In FY 2013, overnight and 2-day service performance met or exceeded service performance goals and remained similar to that of FY 2012. Although the actual level of service has been reduced and the volume of mail in the 3-5-day service standard category has increased, service performance for the 3-5-day category decreased slightly versus last year and did not reach either the old FY 2012 service performance target of 92.85 percent or the new FY 2013 service performance target of 95.00 percent.

Presorted Letters/Postcards

Presorted Letters/Postcards exceeded annual service performance goals for each service standard category in FY 2013. Mail Processing Network Rationalization caused a noticeable shift in volume between the overnight, 2-day, and 3-5-day service standard categories. Specifically, measured volumes with an overnight or 2-day service standard decreased, while the measured volumes in the 3-5-day service standard category increased in comparison to FY 2011 and FY 2012 amounts. Figure V-2 illustrates that the shift in volume correlates to the implementation of service standard changes. Although the actual level of service provided has been modified, there has been no perceivable change in measured service performance. However, the change in service standards does make it difficult to directly compare FY 2012 and FY 2013 service performance results.

Figure V-2
First-Class Mail Presorted Letters/Postcards Pieces



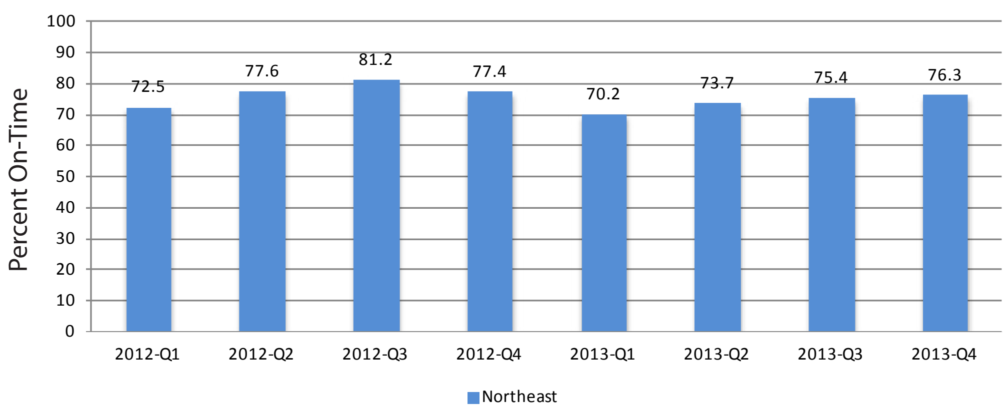
Flats

Service performance for First-Class Mail Flats did not meet annual on-time performance goals in FY 2013. Service performance for Flats has not met annual targets for three consecutive years. Similar to First-Class Mail Presorted Letters/Postcards, the volume of First-Class Mail Flats with a 3-5-day service standard increased in FY 2013, corresponding to the Postal Service's change in service standards associated with Mail Processing Network Rationalization.

First-Class Mail Flats include both single-piece and presorted Flats. The Postal Service measures single-piece Flats through the EXFC system, while service performance for presorted Flats uses single-piece as a proxy.[16] A proxy is used because there is an insufficient number of pieces with a Full-Service IMb to make reliable service performance estimates.[17]

The Northeast area, especially for the 3-5-day service standard category, has been a consistent underperformer and is a partial reason for below-target national scores.[18] In quarters 1 through 4 of FY 2013, the Northeast area posted the lowest performance results relative to the other six measured service areas. The Postal Service mentions the impact of weather in quarters 1 and 2 as a partial reason for this service target not being met.[19] Figure V-3 shows that since FY 2012, mail with a 3-5-day service standard originating from and destinating to the Northeast area has averaged 75.5 percent on-time versus 79.1 percent for the other areas with the same service standard.

Figure V-3
Standard Mail Flats Northeast Area
Service Performance Results FY 2012—FY 2013



[16] Library Reference USPS-FY13-29. *See also* United States Postal Service, Service Performance Measurement, June 2008, at 7 n.3, attached to Docket No. PI2008-1, Order No. 83, Second Notice of Request for Comments on Service Performance Measurement Systems for Market Dominant Products, June 18, 2008.

[17] Library Refernce USPS-FY13-29. The Postal Service states that 68 percent of First-Class Mail Flats were mailed at Single-Piece rates.

[18] In FY 2013, measured Flats mail with a 3-5-day service standard from the Northeast represented 12.9 percent of total Flats with the same service standard.

[19] The Postal Service says 3-5-day single-piece mail utilizes the air transportation network, which is most susceptible to impact from weather. During quarters 1 and 2 in FY 2013, Hurricane Sandy and Winter Storm Nemo paralyzed the East Coast and Northeast corridor. Library Reference USPS-FY12-29.

Parcels

Service performance for Parcels also did not meet the annual service performance target in FY 2013. In quarter 1 of FY 2013, the Northeast area posted the lowest performance results among each service standard category—likely due to the effects of Hurricane Sandy.[20] Service performance results for the overnight, 2-day, and 3-5-day service standards have shown steady improvement in FY 2013 compared with FY 2012.

Single-Piece International Inbound and Outbound

In FY 2013, service performance for Inbound and Outbound Single-Piece First-Class Mail International did not meet the annual target of 94 percent on-time delivery. Unlike other products within First-Class Mail, the annual targets have not increased from targets set in FY 2011.

Only the service performance results for First-Class Mail Presorted Letters/ Postcards met or exceeded annual targets for overnight, 2-day and 3-5 day service standards. Service performance results for Single-Piece Letters/Postcards overnight and 2-day service standards met the annual target, but for 3-5 day service standards, the performance results were below the annual target. Service performance for Flats and Parcels remains well under target, as does service performance for all but overnight Outbound Single-Piece First-Class Mail. The Postal Service must improve performance for products that did not meet the annual targets. The Postal Service should take appropriate action to improve performance for these products.

Standard Mail

In FY 2013, Standard Mail products constituted 51.9 percent of total mail delivered and 46.7 percent of total mail measured by the Postal Service.[21] Table V-3 shows that service performance for Standard Parcels and High Density and Saturation Letters met or exceeded the on-time delivery targets set by the Postal Service. High Density and Saturation Flats/Parcels and Letters did not meet on-time delivery targets. Performance for both Carrier Route and Flats did not meet on-time delivery targets, falling below 80 percent on-time delivery, but made meaningful increases in performance when compared to FY 2012.

[20] *Id.*

[21] PRC-FinRpt-13.

Table V-3
Service Performance Results for Standard Mail

	FY 2013	FY 2012	FY 2011	Target
	Percent On-Time	Percent On-Time	Percent On-Time	
High Density and Saturation Letters	90.8	87.2	86.9	90.0
High Density and Saturation Flats/Parcels	87.0	90.8	76.6	90.0
Carrier Route	79.7	70.6	50.1	90.0
Letters	85.9	80.7	71.3	90.0
Flats	76.9	59.9	59.9	90.0
Parcels	98.7	N/A	N/A	90.0
Mixed Product Letters	85.9	79.5	67.7	90.0
Mixed Product Flats	80.2	66.8	59	90.0

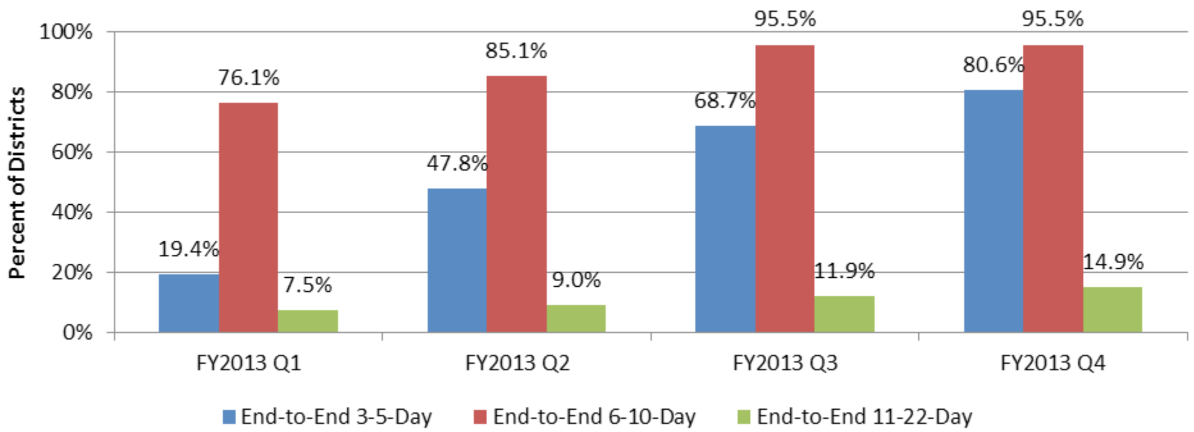
Mixed Product Letters and Mixed Product Flats are not products, but are categories that account for Standard Mail Letters and Flats without proper documentation used to categorize a mailpiece. *See* Library Reference USPS-FY13-29 at 10; FY 2012 ACD at 54.

High Density and Saturation Letters

Service performance for High Density and Saturation Letters has improved each year since FY 2011. In FY 2013, for the first time, service performance results exceeded the annual target of 90 percent on-time delivery.

The Postal Service increased the scope of measurement for High Density and Saturation Letters by capturing product-level data from more regions and districts nationwide. Figure V-4 shows that for End-to-End measurement, the percentage of districts providing IMb data increased in FY 2013. The number of districts measuring the End-to-End 11-22-day service standard remains low, with only 15 percent of districts providing IMb data to the Postal Service.

Figure V-4
District-Level IMb Coverage



High Density and Saturation Flats/Parcels

Table V-4 shows that only service performance results for destination entry mail with a 2-day, 3-4-day and 5-10-day service standard were measured.

Table V-4
Service Performance Results for
High Density and Saturation Flats/Parcels

HDS Flats Components	FY 2013 Q1	FY 2013 Q2	FY 2013 Q3	FY 2013 Q4
End-to-End 3-5-day	N/A	N/A	N/A	N/A
End-to-End 6-10-day	N/A	N/A	N/A	N/A
End-to-End 11-22-day	N/A	N/A	N/A	N/A
Destination Entry 2-day	94	94.2	94.4	94
Destination Entry 3-4-day	66.9	84	87.5	83.8
Destination Entry 5-10-day	80.5	89.4	91.7	92.9

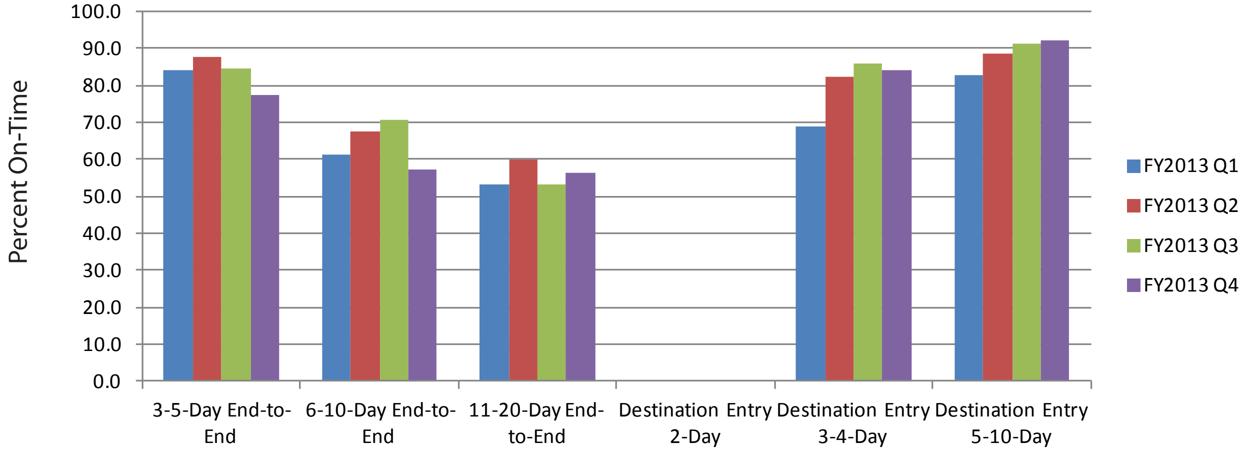
The amount of High Density and Saturation Flats/Parcels pieces measured by IMb grew considerably compared to FY 2012. In fact, the number of High Density and Saturation Flats/Parcels pieces increased 678 percent in FY 2013 as a result of better mailer identification.[22] The Commission commends the Postal Service for increasing product-level IMb volume as it is generally positive for service performance measurement.

Carrier Route

Service performance for Carrier Route mail increased compared to FY 2011 and FY 2012. Most of this improvement is due to the performance of its 3-4-day and 5-10-day destination entry mail. Figure V-5 illustrates service performance for the destination entry and End-to-End components of this product. The figure also shows that the destination entry component had consistent increases in service performance in FY 2013. In contrast, mail measured End-to-End showed decreasing or inconsistent service performance results during the same time.

[22] The percentage increase was calculated using the sum of the number of measured pieces in each of the 4 quarters of FY 2012 compared with the corresponding sum for FY 2013. *See* United States Postal Service, FY 2012 and FY 2013 Quarterly Service Performance Reports.

Figure V-5
Carrier Route Service Perfomance Results

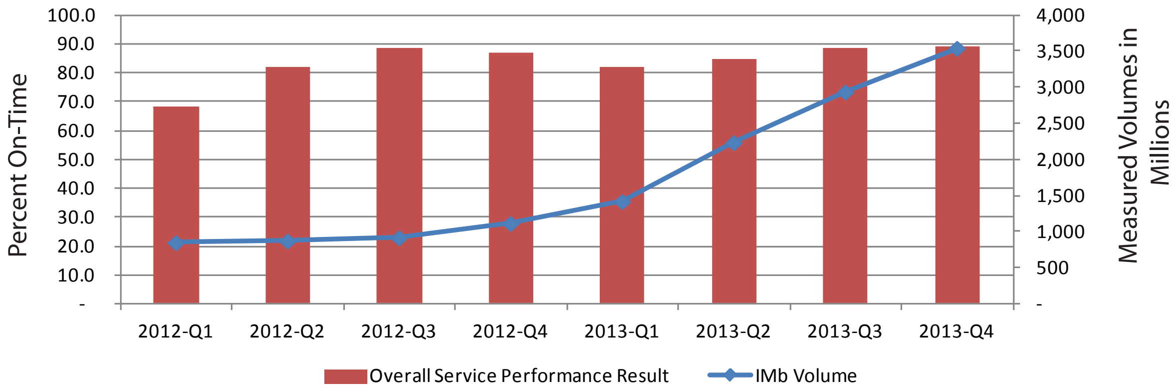


Note: Carrier Route service performance results were not available for 2-day destination entry.

Letters

For Standard Mail letters, service performance and the volume of pieces measured by IMb have consistently increased over three consecutive years. In addition, all geographic areas for each component and service standard have provided IMb data used to measure service performance. Figure V-6 illustrates the increasing trend in both volume and service performance across eight consecutive quarters.

Figure V-6
Standard Mail Letters Service Performance and IMb Volume



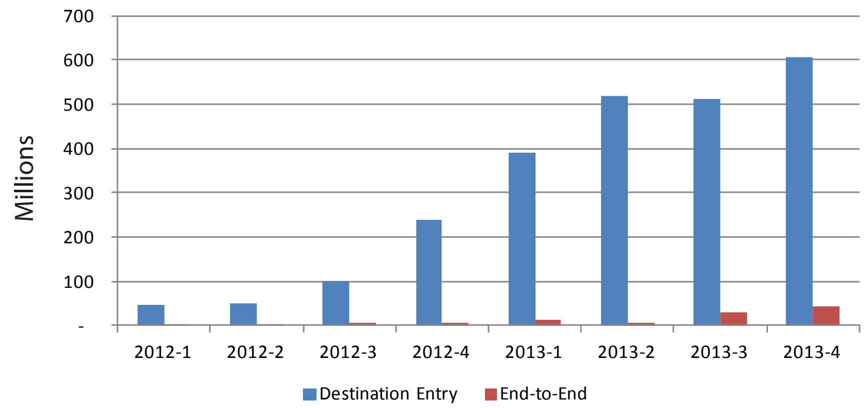
Source: United States Postal Service, FY 2012 and FY 2013 Quarterly Service Performance Reports.

The proportion of destination entry (96 percent of Standard Mail Letter volume) and End-to-End (4 percent of Standard Mail Letter volume) mail measured in FY 2013 remained consistent despite the significant increase in the volume of letters.

Flats

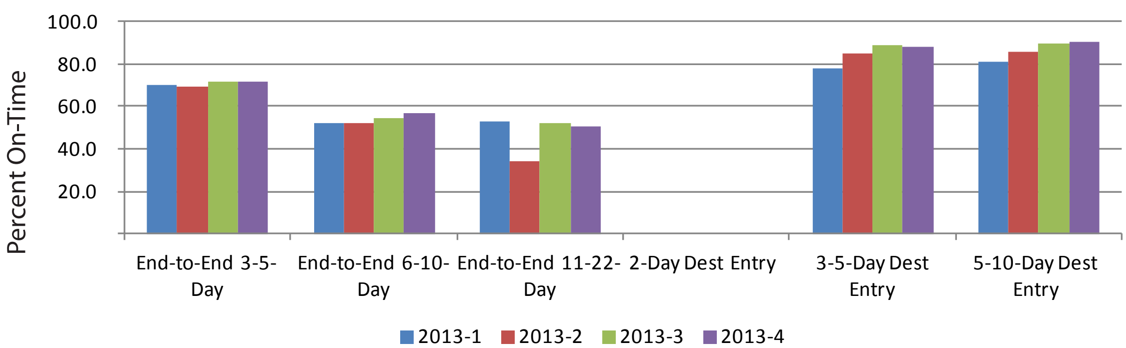
Standard Mail Flats on-time service performance increased significantly in FY 2013, from 59.9 percent to 76.9 percent. The annual volume of Flats measured by IMb increased from approximately 460 million in FY 2012 to 2.1 billion in FY 2013. Figure V-7 illustrates the trend of measured mailpieces across eight quarters. The figure also reveals the sizeable proportion of destination entry mail versus End-to-End mail in measurement.

Figure V-7
Type of Standard Mail Flats in Measurement



The End-to-End component of Standard Mail Flats did not show the same increase in service performance results as destination entry. In fact, in FY 2013, End-to-End 11-22-day service performance results decreased from 53.1 percent on-time delivery in quarter 1 to 50.6 percent in quarter 4. Figure V-8 shows that the overall score and increase in FY 2013 service performance results were mostly due to relatively better performance from destination entry mailpieces.

Figure V-8
Standard Mail Flats Service Performance



Note: Standard Mail Flats service performance results were not available for 2-day destination entry.

Parcels

FY 2013 marked the first year service performance results were presented for Parcels. Only quarter 1 and 2 results are included because there were no data for quarters 3 and 4. The Postal Service explains that "the volume of measurable pieces was very low" even for quarters 1 and 2.[23] The Southern Area revealed very low measurable volume.[24]

Service Performance for High Density and Saturation Letters and Parcels exceeded the annual service performance goal of 90 percent on-time delivery, while service performance for Letters and High Density and Saturation Flats/Parcels was close to meeting the target. Flats and Carrier Route products had the lowest service performance scores among Standard Mail products despite significant improvement compared to FY 2011 and FY 2012. While IMb measurements increased for some products, the Postal Service should continue to address concerns of low IMb volumes or unavailable IMb data provided at the district level in order to assure reliable service measurement.

Periodicals

Table V-5 shows that annual service performance for Periodicals increased notably from FY 2012. The Postal Service previously asserted that increased volumes of Periodicals in measurement allow diagnostic tools such as Work-in-Process to provide managers with the visibility to quickly identify and improve work-flows issues.[25] In addition, the diagnostic tool allows the Postal Service to track and troubleshoot problems in the network using information gathered through Intelligent Mail barcodes. The Postal Service maintains that use of processing equipment and its Work-in-Process diagnostic tool improved service performance in FY 2013.[26]

Table V-5
Annual Service Performance for Periodicals

	FY 2013		FY 2012	
	Target	Percent On-Time	Target	Percent On-Time
Within County	91.0	82.0	91.0	68.7
Outside County	91.0	82.1	91.0	68.7

[23] United States Postal Service, Quarterly Performance for Standard Mail Parcels, Scores Report Quarter 2, May 13, 2013.

[24] The Southern Area includes 12 districts: Alabama, Arkansas, Dallas, Fort Worth, Houston, Louisiana, Mississippi, North Florida, Oklahoma, Rio Grande, South Florida, and Suncoast.

[25] *See* Docket No. ACR2012, Library Reference USPS-FY12-29.

[26] FY 2012 ACD at 47; Docket No. ACR2012, Library Reference USPS-FY12-29; Library Reference USPS-FY13-29.

Figure V-9 shows that in FY 2013, a steady increase in the percentage of Periodicals in measurement also accompanied an increase in service performance results (especially, within Outside County Destination Entry). It is difficult to determine that the gradual increase in service performance results is solely related to the increase in the percentage of Periodicals in measurement. First, more observations are needed to make such a determination. Second, another key component in assessing reliability of service performance results is the inclusion of measurable pieces at the district level. Periodicals results, unlike other products using IMb, are not presented at the district level, rather, only at the entry and area level.

Figure V-9
Measured Pieces vs. Performance

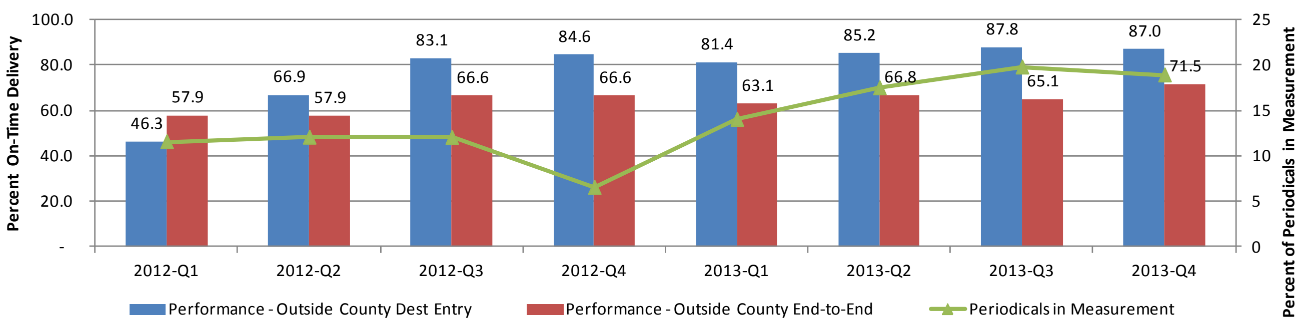


Figure V-9 also reveals a change in pieces measured by IMb one quarter before and after the implementation of service standard changes associated with Mail Processing Network Rationalization. The proportion of Periodicals in measurement doubled after service standard changes were implemented; however, no evidence suggests that the changes impacted service performance.

The Postal Service did not meet its service performance goal for Periodicals. However, compared to FY 2012, service performance results were significantly higher than in FY 2012. In addition, the proportion of Periodicals measured by IMb increased in FY 2013. The Postal Service must continue to improve service performance for Periodicals Mail.

Package Services

Table V-6 illustrates that the service performance for only two of the five Package Services products met their annual service performance targets. Bound Printed Matter Parcels and Media Mail/Library Mail met or exceeded the 90 percent on-time delivery target set for FY 2012 and FY 2013. Service performance for Inbound Surface Parcel Post (at UPU rates) was also relatively high and grew slightly closer to the annual on-time delivery target.

When Single-Piece Parcel Post was transferred to the competitive product list, Alaska Bypass Service remained on the market dominant product list.[27] Upon transfer to the competitive product list, Single-Piece Parcel Post was renamed Standard Post, which the Postal Service is using as the proxy to measure service performance of Alaska Bypass Service. *See* USPS-FY13-29 at 17. For the limited time that Single-Piece Parcel Post was a market dominant product in FY 2013, its service performance remained close to the target for on-time delivery. Because Standard Post is a competitive product, and thus not subject to publicly reporting service performance results, it is an inappropriate proxy for Alaska Bypass Service. Accordingly, as noted below, the Postal Service is directed to develop an appropriate measurement system for Alaska Bypass Service.

Table V-6
Service Performance Results for Package Services

	FY 2013		FY 2012	
	Target	Percent On-Time	Target	Percent On-Time
Single-Piece Parcel Post	90	85.0	90	86.8
Bound Printed Matter Flats	90	62.6	90	54.3
Bound Printed Matter Parcels	90	98.4	90	94.4
Media Mail/Library Mail	90	93.3	90	92.7
Inbound Surface Parcel Post (at UPU rates)	90	87.8	90	86.8

In FY 2013, service performance for Bound Printed Matter Flats was well below other Package Services products for the second consecutive year. The Postal Service suggests that improved diagnostics and an increase in mailers utilizing Full-Service IMb should lead to improved service performance results in future years.[28] As seen in Table V-7, for End-to-End BPM Flats, none of the 67 districts reported service performance results from quarter 2 FY 2012 to quarter 2 FY 2013. In quarter 3 FY 2013, results for End-to-End BPM Flats were provided by 97 percent of the districts and by quarter 4 all districts were providing data.

Table V-7
Service Performance Results for Bound Printed Matter Flats

Percentage of Districts with IMb data	FY 2012				FY 2013			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Destination Entry	99%	99%	99%	100%	100%	100%	100%	100%
End-to-End	85%	0%	0%	0%	0%	0%	97%	100%

[27] Single-Piece Parcel Post was moved to the competitive product category in January 2013. Results shown for FY 2013 include only the portion of the year for which the product was categorized as market dominant. *See* Library Reference USPS-FY13-29 at 15.

[28] *See* Library Reference USPS-FY13-29.

The overall service performance result for BPM Flats does not include four quarters of results from the End-to-End component in FY 2012 or FY 2013. Nevertheless, service performance for destination entry, which made up 95 percent of measured volume in FY 2013, has been consistently increasing. Part of the increase is due to the strong performance in the Eastern Area; it outperformed other geographic regions, increasing 54 percent from quarter 1 to quarter 4.

As noted above, Single-Piece Parcel Post was transferred to the competitive product list in January 2013. Until then, Single-Piece Parcel Post was used as a proxy to measure the service performance of Inbound Parcel Post (at UPU rates). Due to the transfer, in the FY 2012 ACD, the Commission instructed the Postal Service to "propose use of an appropriate measurement system or proxy for Inbound Surface Parcel Post (at UPU rates) for service performance measurement in FY 2013." FY 2012 ACD at 61. The Postal Service continues to use Single-Piece Parcel Post as the proxy to measure service performance for Inbound Surface Parcel Post (at UPU rates).[29] Single-Piece Parcel Post (renamed Standard Post) is now a competitive product for which no publicly available service performance data are available, so it is an inappropriate proxy for measuring the performance of Inbound Surface Parcel Post (at UPU rates). The Postal Service must propose an appropriate measurement system for Inbound Surface Parcel Post (at UPU rates).

Service performance for Media Mail/Library Mail and Bound Printed Matter Parcels exceeded the Postal Service's annual service performance target of 90 percent on-time delivery. Service performance for other products, such as Single-Piece Parcel Post and Inbound Surface Parcel Post, remained similar to FY 2012 and close to the annual target. For Bound Printed Matter Flats, service performance results remain the lowest among Package Services products and the Postal Service continues to receive low volumes of measurable data from mailers. For this product, the Postal Service should develop strategies to enhance Full-Service mailer participation and increase service performance results.

Within 90 days of the issuance of this ACD, the Postal Service shall propose to the Commission appropriate measurement systems for both Inbound Surface Parcel Post (at UPU rates) and Alaska Bypass Service.

Special Services

The Postal Service exceeded targets for each product within the Special Services category. Notably, service performance for Ancillary Services and Post Office Box Service has declined versus previous years. Table V-8 compares the most recent results to previous years and the annual target.

[29] *See* Responses of the United States Postal Service to Questions 1-9 of Chairman's Information Request No. 6, February 18, 2014, question 9 (Response to CHIR No. 6). 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.

Table V-8
Service Performance Results for Special Services

	FY 2013	FY 2012	FY 2011	Target
Ancillary Services	91.4	93.4	93.4	90.0
International Ancillary Services	99.3	99.6	99.6	90.0
Address List Services	100.0	83.3	93.3	90.0
Confirm	99.7	98.8	99.7	90.0
Money Orders	99.2	99.2	97.2	90.0
Post Office Box Service	90.9	92.6	93.1	90.0
Customized Postage	-	-	-	-
Stamp Fulfillment Service	99.5	96.7	-	-

CUSTOMER ACCESS

Introduction

Pursuant to 39 CFR 3055.91, the Postal Service must provide data to the Commission on the number and type of post offices, including post offices under emergency suspension as well as information on the number of collection boxes in its network. 39 CFR 3055.91 also requires the Postal Service to provide information about average customer wait time in line by fiscal quarter.

Pursuant to 39 CFR 3055.92, the Postal Service is to provide to the Commission a copy of its Customer Experience Measurement Instrument (CEM) (survey). Additional information such as the type of customer surveyed, the number of surveys initiated and received, and, where a question asked is subject to multiple responses, the number of responses for each question, disaggregated by each of the possible responses is also to be provided.

The Postal Service supplements its reporting with information on alternative access channels.

Maintaining adequate customer access continues to be important. Over the years, the Postal Service has reduced its retail network by either closing postal retail facilities or reducing hours of operation. The number of collection boxes and other collection points has been reduced. However, access to postal services has been supplemented with the addition and enhancement of alternative marketing channels.

Retail Facilities

Table V-9 provides the number of Postal Service retail facilities by type for FY 2011 through FY 2013. The aggregate number of Postal Service-operated retail facilities (i.e., post offices stations and branches) has declined each year since FY 2011, although the rate of facility closings decreased in FY 2013. The total number of non-Postal Service operated retail outlets increased from FY 2012 to FY

2013. This increase can be primarily attributed to the establishment of 338 new Village Post Offices (VPOs). The number of contract postal units (CPUs) and community post offices (CPOs) together declined by 263 facilities from FY 2012 to FY 2013. The aggregate number of facilities in FY 2013 is 35,434, sixty-five more than in FY 2012.

Table V-9
Postal Service Operational Retail Facilities

Facility Type	FY 2013	FY 2012	FY 2011	FY 2013 Change from FY 2012	FY 2012 Change from FY 2011
Post Offices	26,670	26,755	26,927	(85)	(172)
Classified Stations & Branches and Carrier Annexes	5,032	5,102	5,219	(70)	(117)
Total Postal-managed	**31,702**	**31,857**	**32,146**	**(155)**	**(289)**
Contract Postal Units	2,718	2,792	2,904	(74)	(112)
Village Post Offices	385	47	-	338	47
Community Post Offices	629	673	706	(44)	(33)
Total Offices, Stations & Branches	**35,434**	**35,369**	**35,756**	**65**	(387)

Note: These totals do not include offices under emergency suspension.

Source: USPS 2013 Annual Report to Congress at 34.

POStPlan

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 nearly 32,000 post office retail locations to more closely reflect the workload at these offices.[30] The Commission issued its Advisory Opinion on August 23, 2012.[31]

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 V-10 shows the total 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 retail access to postal service in the following ways:

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

[30] 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.

[31] Docket No. N2012-2, Advisory Opinion on Post Office Structure Plan, August 23, 2012.

Table V-10
Proposed Changes 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: Library Reference USPS-LR N2012-2/11

The Postal Service is implementing POStPlan in several phases. The first set of post offices transitioned under POStPlan were those offices to be upgraded to EAS Level 18, which entails increased administrative responsibilities for the Postmaster, but no change in hours of operation. The Postal Service is currently transitioning offices slated for reduction of operating hours where there is a current Postmaster vacancy. Finally, beginning on, or about September 2014, those offices with occupied Postmaster positions will begin to transition.

Table V-11 shows the progress in implementation of POStPlan through the end of FY 2013. The table demonstrates that just over 61 percent of the offices proposed for reduced hours have been transitioned. The implementation of POStPlan appears to be uniformly distributed among projected Level 2 (2-hours per weekday), Level 4 (4-hours per weekday) and Level 6 (6-hours per weekday). The Postal Service posts POStPlan Headquarters Status Updates on its website, as well as the dates of upcoming POStPlan community meetings, to inform the public of the status of potential changes in operating hours of their local post offices. The Postal Service states that as a result of POStPlan's implementation, it has achieved $171 million in annual savings to date.[32]

Table V-11
POStPlan Status at Year-End FY 2013

(Number of Offices)

Projected Office Level	As Proposed in N2012-2	Status as of EOFY 2013	Percent Converted
Level 2	1,891	1,090	57.6%
Level 4	6,837	4,203	61.5%
Level 6	4,333	2,692	62.1%
Total	13,061	7,985	61.1%

Source: USPS FY 2013 Annual Report to Congress at 19, 48.

[32] United States Postal Service 2013 Annual Report to Congress, at 19; Library Reference USPS-FY13-17.

Post Office Suspensions

Table V-12 shows the number of postal-operated retail facilities with suspended operations at the conclusion of FY 2013.

Table V-12
Number of Offices Under Suspension FY 2013

	Under Suspension at the Start of the Fiscal Year	Suspended During the Fiscal Year	Not Reopened/Closed During the Fiscal Year	Under Suspension at the End of Fiscal Year
Post Office	277	77	24	330
Station/Branch	59	28	3	84
Total	**336**	**105**	**27**	**414**

Source: Response to CHIR No. 1, question 7, Library Reference USPS-FY13-43

Table V-13 shows a breakdown of the 414 offices with suspended operations at the end of FY 2013 by the reason for the suspension. Postal Service Handbook PO 101 specifies the circumstances that may justify a suspension as including:

- 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.[33]

As shown in Table V-13, the leading cause of suspensions is lease expirations/terminations which account for 39 percent of the total. Lack of qualified personnel is the second leading cause at 23 percent.

[33] United States Postal Service Handbook PO-101, October 2012, (USPS Handbook PO-101), at 39.

Table V-13
Number of Offices Under Suspension

Suspension Reason	Number of Offices	Percent of Total FY 2013
Lease Expiration/Termination	161	38.9%
Lack of Qualified Personnel	97	23.4%
Health/Safety	91	22.0%
Natural Disasters	37	8.9%
Other	5	1.2%
No Data	23	5.6%
Total	414	100.0%

Source: Response to CHIR No. 1, question 7, Library Reference USPS-FY13-43; Library Reference USPS-FY12-46.

The Postal Service's formal discontinuance process is set out in USPS Handbook PO 101.[34] The first step in investigating possible discontinuance is an official decision to undertake a feasibility study. This step involves, among other things, information gathering which includes customer questionnaires to gather additional information about a community, its postal customers and their access to delivery and retail services. After a Headquarters Review Coordinator confirms that the review complies with federal law and Postal Service policy, a formal proposal to discontinue the facility is prepared and forwarded to the district manager before it is issued. A community meeting can be held any time after the customer questionnaires have been sent out and before any final determination can be made.

If the proposed action appears warranted, a formal proposal to discontinue the facility is prepared and forwarded to the district manager before it is posted. A written copy of the proposal and an invitation for comments must be posted for at least 60 days in the retail facility under study and surrounding facilities. Comments received are then analyzed by management. After review by the district manager, the proposal may be allowed to continue or halted as unwarranted.

If the proposal is found to be warranted, then a final determination is prepared and posted for at least 30 days in the affected facilities where the proposal had originally been posted. The Postal Service then observes an additional 30 day waiting period. If there are no appeals to the Commission, the retail facility is officially discontinued, at the earliest, 60 days after the first day of posting of the final determination.

Data supplied by the Postal Service in this proceeding appear to indicate that as many as three-quarters of offices remaining under suspension have entered the formal discontinuance process. However, some of these offices had been under study for possible discontinuance under previous facility reduction initiatives as evidenced by the fact that at least 52 of the offices currently under

[34] *Id.* at 29-33.

suspension have had Final Determinations issued, primarily in FY 2011, and yet remain in suspension.[35] The discontinuance studies performed for these offices are over 2 years old and may have to be updated if the Postal Service chooses to proceed in discontinuing these offices.

The Commission has recommended that the Postal Service proceed expeditiously in either discontinuing offices under suspension or reopening them.[36] It reiterates that recommendation in this proceeding.

Delivery Points

Table V-14 provides the number of residential and business delivery points by delivery type for FY 2010 through FY 2013. The change in delivery points among the years is also shown. There has been an upward trend, with an overall increase of 773,882 delivery points from FY 2012 to FY 2013. The growth in delivery points in FY 2013 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 2013 than in FY 2012. For FY 2013, the average pieces per delivery point was 1,036 as shown in Table V-15. In contrast, the USPS reported the average pieces per delivery point was 1,529 in FY 2000.[37] There has been a steady decrease in the ensuing years.

Table V-14
Postal Service Delivery Point Statistics

Residential Delivery Points	FY 2013	FY 2012	FY 2013 Change from FY 2012	FY 2011	FY 2012 Change from FY 2011
City Delivery	81,297,883	81,040,591	257,292	80,792,112	248,479
Rural	40,111,620	39,449,400	662,220	39,067,740	381,660
PO Box	15,882,717	15,994,508	(111,791)	15,891,349	103,159
Highway Contract	2,736,005	2,678,508	57,497	2,639,061	39,447
Total Residential Delivery	**140,028,225**	**139,163,007**	**865,218**	**138,390,262**	**772,745**
Business Delivery Points					
City Delivery	7,554,231	7,525,979	28,252	7,487,332	38,647
Rural	1,524,741	1,493,644	31,097	1,468,861	24,783
PO Box	3,738,314	3,889,964	(151,650)	4,072,664	(182,700)
Highway Contract	74,922	73,957	965	72,872	1,085
Total Business Delivery	**12,892,208**	**12,983,544**	**(91,336)**	**13,101,729**	**(118,185)**
Total Delivery Points	**152,920,433**	**152,146,551**	**773,882**	**151,491,991**	**654,560**

Source: USPS 2013 Annual Report to Congress at 34.

[35] *See* Library Reference USPS-FY11-44.

[36] *See* Docket No. PI2010-1, Order No. 335, Notice and Order Providing an Opportunity to Comment, November 9, 2009, at 2.

[37] FY 2012 ACD at 67.

Table V-15
Annual Pieces Per Delivery Point

	FY 2013	FY 2012	FY 2011	FY 2010	FY 2009
No. of Pieces (Millions)	158,384	159,859	168,297	170,859	176,744
Pieces/Delivery Point	1,036	1,051	1,111	1,133	1,177

Source: USPS 2013 Annual Report to Congress at 34.

Wait Time in Line

Tables V-16 and V-17 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 V-16 shows the average wait time in line by administrative area for FY 2013 and FY 2012. The average wait decreased across the board except in the Great Lakes region where it increased by 3 seconds.

Table V-16
Postal Service Identified
Average Wait Time in Line

	Average Wait Time in Line	
Area	FY 2013	FY 2012
Capital Metro	2:19	2:22
Eastern	2:16	2:24
Great Lakes	2:00	1:57
Northeast	2:21	2:23
Pacific	3:19	3:25
Southern	2:22	2:33
Western	2:48	2:58
National	2:29	2:34

Source: Library Reference USPS-FY13-33.

The Postal Service has emphasized its goal of lowering the average wait time to less than 5 minutes. According to the Postal Service, this is the ideal length of wait time between cost effectiveness, efficiency, and service. The Postal Service states that the primary source of their wait time in line data is the mystery shopper program. The Postal Service has explained that wait time in line data are obtained from the mystery shopper program and not the CEM survey.[38] It further explained that the CEM separately asked questions about customers' impressions of their visits, but this information is not used in calculating wait time in line. Thus, 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. Table V-17 summarizes the responses received from the CEM for small/medium businesses and residential post office users. A majority of respondents indicated that their wait time was in fact less than 5 minutes. However, there is still room left for improvement.

Table V-17
CEM Identified
Average Wait Time in Line

	Small/Medium Business			Residential		
Wait Time in Line	**FY 2013**	**FY 2012**	**FY 2011**	**FY 2013**	**FY2012**	**FY 2011**
Less than 1 minute	18.0%	18.1%	17.6%	19.0%	19.1%	18.5%
1-3 minutes	30.5%	30.5%	29.3%	31.6%	31.9%	30.7%
4-5 minutes	23.4%	23.3%	23.1%	24.1%	23.7%	23.6%
Subtotal 5 minutes or less	71.9%	71.9%	69.9%	74.7%	74.7%	72.8%
6-10 minutes	16.2%	16.0%	16.6%	15.0%	14.9%	15.5%
11-15 minutes	6.8%	6.9%	7.4%	5.8%	5.9%	6.4%
16 minutes or more	5.2%	5.3%	6.1%	4.5%	4.5%	5.3%
Total	100%	100%	100%	100%	100%	100%

Source: Library Reference USPS-FY13-33; FY 2012 ACD at 68.

[38] FY 2012 ACD at 69.

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, mail chutes, firm pick-ups, Automated Postal Centers (APCs) 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 addresses, location-types (i.e., Business, Residential, Post Office Lobby, etc.), box types (standard, jumbo, snorkel, etc.), days of the week the point is accessed and the times (including the final collection time) it is accessed.

Table V-18 shows the number of collection points by location-type. Figure V-10 illustrates the decline in the number of collection points from 2000 to 2013.

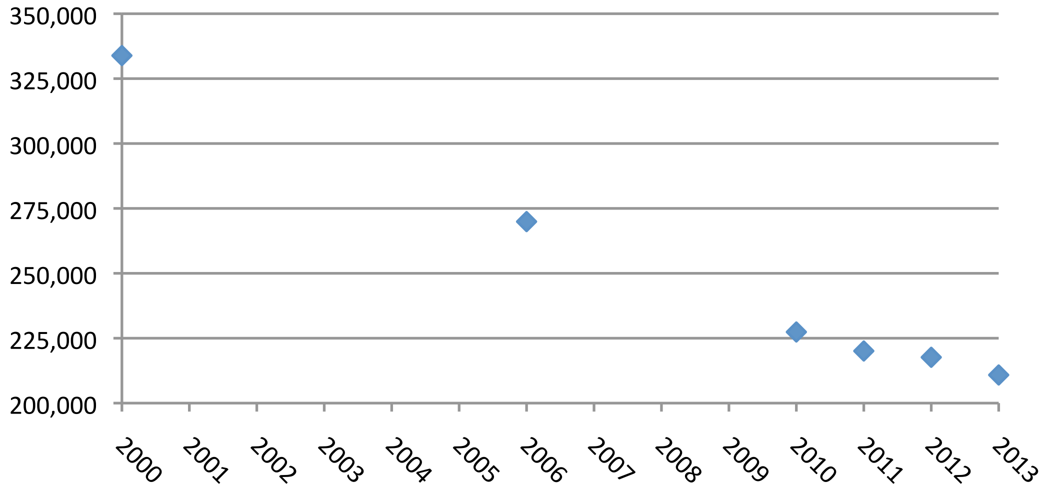
Table V-18
Number of Collection Points by Location Type

	Year			Change in Number	Percent Change	Change in Number	Percent Change
Location-Type	**2013**	**2012**	**2006**	**2013-2006**		**2013-2012**	
Business	78,939	82,142	108,418	(29,479)	-27.2%	(3,203)	-3.9%
Residential[1]	39,731	41,019	61,038	(21,307)	-34.9%	(1,288)	-3.1%
Post Office Outside	42,996	45,167	53,665	(10,669)	-19.9%	(2,171)	-4.8%
Post Office Lobby	38,709	39,236	37,110	1,599	4.3%	(527)	-1.3%
Customer Lobby	3,614	3,817	4,057	(443)	-10.9%	(203)	-5.3%
Other	4,168	3,795	3,191	977	30.6%	373	9.8%
Contract Station	1,024	938	948	76	8.0%	86	9.2%
Mail Room	758	749	807	(49)	-6.1%	9	1.2%
Customer Dock	314	262	464	(150)	-32.3%	52	19.8%
Airport	150	152	152	(2)	-1.3%	(2)	-1.3%
Government Building	316	275	68	248	364.7%	41	14.9%
Approved Shipper	118	99	0	118	N/A	19	19.2%
Grand Total	210,837	217,651	269,918	(59,081)	-21.9%	(6,814)	-3.1%

[1] Collection boxes account for over 99% of residential collection points.

Source: Response to CHIR No. 2, question 6, Library Reference USPS-FY13-43.

Figure V-10
Total Collection Points



Note: Collection boxes account for 75 precent of all collection points.

Figure V-11
Business and Residential Collection Points

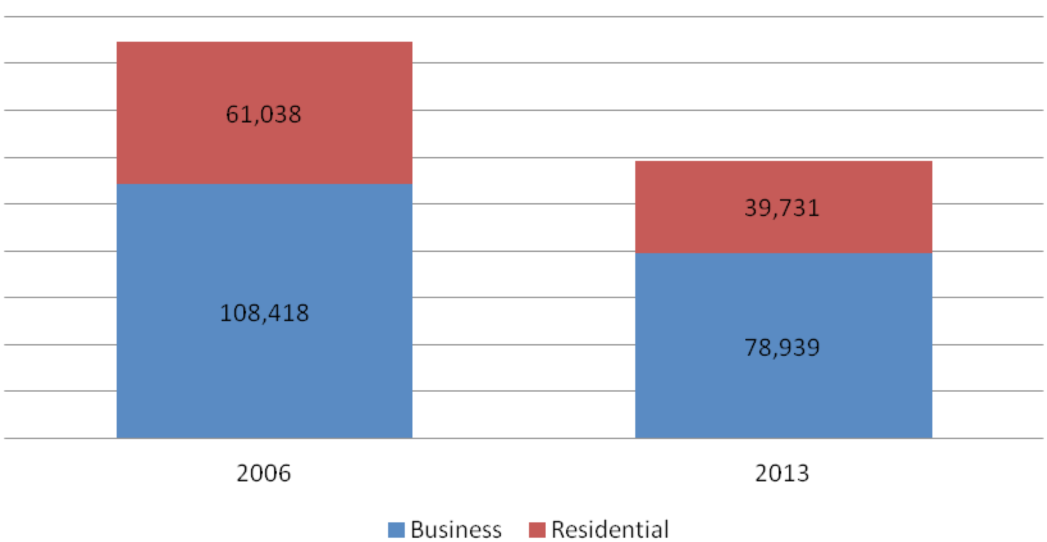
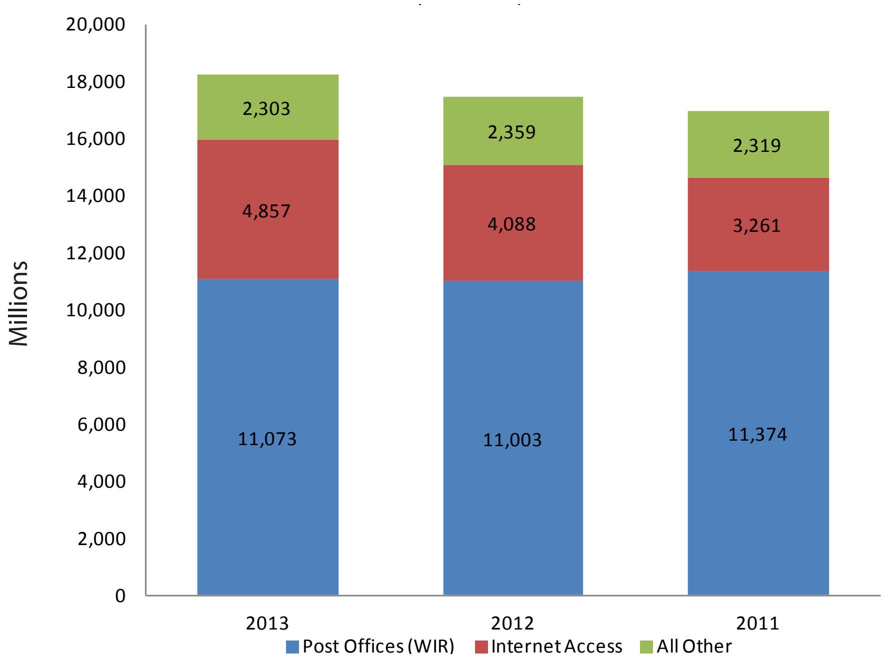


Figure V-11 shows the total number of business and residential collection points in FY 2006 and FY 2013. During this period, the number of business collection points declined by 27.2 percent and the number of residential collection points declined by 34.9 percent.

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. In FY 2013, over 40 percent of retail revenue was generated through means other than a postal retail counter. Figure V-12 identifies the FY 2013 revenue each retail channel generated. The channels represented on Figure V-12 are Post Offices' walk-in revenue, which is Post Office walk-in revenue plus walk-in revenue from Contract Postal Units (CPUs), and Internet Access, which consists of "PC Postage" and "Click-N-Ship." The last category, All Other, consists of "Stamps only sales by retail partners," Automated Postal Centers (APCs), and "Stamps by mail/phone/fax."

Figure V-12
Retail Revenue by Channel



Note: WIR = Walk-In Revenue

Source: CHIR No. 1, question 5; 2012 ACD at 72.

The share of revenues derived from Automated Postal Centers (APCs) located in post office lobbies in larger facilities has declined from 3.2 percent in FY 2011 to 2.5 percent in FY 2013. The number of APCs has remained nearly constant over the years, as shown in Table V-19. Surveys distributed by the Postal Service indicated that upwards of 80 percent of small/medium business customers and residential customers find that a "self-service mailing and shipping center is easy to use."

Table V-19
Number of Automated Postal Centers

FY	Number of APCs
2013	2,166
2012	2,132
2011	2,143
2010	2,142
2006	2,164

Source: Response to CHIR No. 2, question 6; Library Reference USPS-FY13-43; 2012 ACD at72.

In its FY 2012 Annual Report to Congress, the Postal Service indicated that, in response to comments received, it planned to add APCs by early 2013.[39] The data shown in Table V-19 indicate a net increase of only 34 APCs. Data provided by the Postal Service in FY 2012 ACD appeared to indicate that many of the APCs in service were nearing the end of their service lives.[40] Thus, many of the newly installed APCs may have replaced existing units which were at the end of their useful service lives, rather than having been installed in new locations.

Contract Postal Units (CPUs) and Community Post Offices (CPOs) offer a range of postal services in addition to the sale of stamps. CPUs are usually located in a place of business and operated by a contractor who accepts mail from the public, sells postage and supplies, and provides special services (e.g., Postal Money orders or Registered Mail). CPOs provide services in a community where no post office exists.[41] As indicated by Table V-20, the number of CPUs and CPOs is declining. Their respective revenue amounts are also decreasing.

Table V-20
Number of Contract Postal Units (Non-Postal Managed)

Office Type	Total at Start of FY 2013	Closings	Openings	Total at End of FY 2013
Contract Postal Units	2,848	321	194	2,721
Community Post Offices	663	149	-	514
Total Contract Units	**3,511**	**470**	**194**	**3,235**

Source: Response to CHIR No. 1, question 4.

[39] United States Postal Service FY 2012 Annual Report to Congress at 47.

[40] FY 2012 ACD at 73.

[41] Glossary of Postal Terms, United States Postal Service, Publication 32, July 2013, at 45.

Village Post Offices (VPOs) provide a limited range of services that include selling First-Class Mail stamps, offering Priority Flat rate shipping products, delivering to P.O. boxes, and accepting 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.[42] The first VPOs were initiated in 2011.[43] VPOs are located in community businesses, town halls, and government centers. By being located at businesses and other places that customers already frequent, the Postal Service contends that VPOs will offer Postal Service customers time-saving convenience and in many instances longer hours of operation than regular Post Offices.[44] As of December 31, 2013, there were a total of 382 VPOs open across the nation. Three hundred thirty-one opened in FY 2013. The states in which they are primarily located are Indiana, Kentucky, Virginia, Michigan, and Pennsylvania. These five states account for approximately 44 percent of the total VPOs in the nation. VPOs are limited substitutes for full service postal retail facilities.[45]

CUSTOMER EXPERIENCE

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 CEM system for gauging customer experience and satisfaction with sending and receiving mail, visiting the Post Office, and contacting the Post Office.[46] The CEM system randomly selects residential and small/medium business customers and surveys them via online or hard copy. Large business customers were asked to complete an online survey only. 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. Responses are broken down based on the type of customer: Residential, Small/Medium Business, and Large Business. A primary focus for the Postal Service has been to increase the share of Very/Mostly Satisfied responses.

Residential Customers

Approximately 302,000 residential (retail) customers participated in the CEM survey. The majority of residential customers responded positively when asked about their general Postal Service experience in FY 2013.[47] For example, when asked "How satisfied are you with the Postal Service?", 88.2 percent of respondents replied "Very Satisfied" or "Mostly Satisfied." Relative to previous years, this number has remained consistent.

[42] Village Post Office fact sheet, available at http://about.usps.com/news/electronic-press-kits/expandedaccess/vpo-fact-sheet.htm (accessed March 6, 2014).

[43] Docket No. N2011-1, Advisory Opinion on Retail Access Optimization Initiative, December 23, 2011, at 107 (RAOI Opinion).

[44] FY 2012 ACD at 73

[45] RAOI Opinion at 111.

[48] FY 2013 ACR at 41.

[47] A related measure of customer experience is provided by the mystery shopper program. The Overall Retail Experience score from the Retail Customer Experience mystery shoppers for FY 2013 was 92.86 percent. This score is the weighted average of four separate measures, wait time in line score (40 percent), HAZMAT score (15 percent), image score (20 percent), and promotion and merchandising score (25 percent).

Residential customers' perception concerning post office contact have also remained constant. For example, when prompted to agree or disagree that their post office resolves issues in a prompt manner, 59 percent of customers in FY 2013 and 61 percent of customers in FY 2012 said they "Strongly Agree" or "Somewhat Agree."

Respondents expressed general satisfaction with their experiences when visiting the post office. For instance, when asked to remember their most recent visits to a post office, the majority of respondents stated that the location and hours of operation were convenient. Table V-21 shows that in FY 2013, customers generally perceived the post office as convenient.

Table V-21
Residential Responses to Questions

Question	Strongly Agree	Somewhat Agree	Neither Agree nor Disagree	Somewhat Disagree	Strongly Disagree
Is the post office location convenient?	70.0%	22.9%	3.1%	2.7%	1.2%
Are hours of operation convenient?	58.9%	28.6%	4.3%	5.8%	2.4%
Is the mailbox collection schedule convenient?	56.8%	28.1%	9.4%	3.9%	1.9%
Is the location of mail collection boxes convenient?	56.8%	25.3%	8.0%	6.0%	3.9%

Source: Library Reference USPS-FY13-38.

Table V-22 illustrates that in FY 2013, residential customers were generally satisfied with each market dominant product.

Table V-22
CEM Results for Residential Customers

Mail Products and Services	FY 2011	FY 2012	FY 2013
First-Class Mail	94.2	94.7	94.7
Single-Piece International	86.6	87.5	87.3
Standard Mail	84.1	84.8	85.1
Periodicals	87.0	88.0	88.0
Single-Piece Parcel Post	89.2	89.3	89.7
Media Mail	88.4	89.1	89.2
Bound Printed Matter	86.2	87.2	86.9
Library Mail	87	87.9	87.7

Source: Library Reference USPS-FY13-38; Library Reference USPS-FY12-29; FY 2011 ACD at 90.

Small/Medium Business Customers

The Postal Service received nearly 300,000 survey responses from small/medium-size businesses.[48] Eighty-four percent of respondents answered that they were overall "Very" or "Mostly Satisfied" with the Postal Service this past year, the same amount as in FY 2012. In addition, 88.4 percent of respondents said they "Strongly Agree" or "Somewhat Agree" that clerks were friendly/courteous during their last visit to a post office. Survey responses regarding visits to a post office facility showed that small/medium size business customers were satisfied with their location, hours of operation, and collection box pick-up schedule and location. Table V-23 shows responses to several of these survey questions.

[48] Sixty percent of businesses employ 1 to 4 persons.

Table V-23
Small/Medium Business Reponses to Questions

Question	Strongly Agree	Somewhat Agree	Neither Agree nor Disagree	Somewhat Disagree	Strongly Disagree
Is the post office location convenient?	67.0%	24.8%	3.8%	2.9%	1.4%
Are hours of operation convenient?	54.0%	30.9%	5.1%	7.0%	3.0%
Is the mailbox collection schedule convenient?	50.9%	29.0%	10.7%	5.6%	3.9%
Is the location of mail collection boxes convenient?	54.3%	25.2%	10.5%	5.6%	4.5%

Source: Library Reference USPS-FY13-38.

The Postal Service received fewer positive survey responses regarding small/medium size business customers' experiences with contacting a post office when compared to experiences in sending/receiving mail and visiting a post office. For example, only 49 percent of respondents said that they "Strongly Agree" or "Somewhat Agree" when asked if the post office resolved their issue promptly in FY 2013. Positive responses to survey questions regarding resolving issues in a prompt manner have slightly declined from FY 2012 results.

Table V-24 illustrates an increase in satisfaction by small/medium-size businesses for each market dominant product.

Table V-24
CEM Results for Small/Medium Business Customers

Mail Products and Services	FY 2011	FY 2012	FY 2013
First-Class Mail	93.0	93.3	93.3
Single-Piece International	84.0	84.9	84.5
Standard Mail	87.0	87.9	88.0
Periodicals	85.1	86.1	86.0
Single-Piece Parcel Post	88.0	88.9	88.8
Media Mail	87.1	88.2	88.1
Bound Printed Matter	85.0	85.9	85.8
Library Mail	86.0	87.1	86.5

Source: Library Reference USPS-FY13-38; Library Reference USPS-FY12-29; FY 2011 ACD at 90.

Large Business Customers

The Postal Service collected just over 3,400 survey responses from large businesses.[49] The overall satisfaction of these businesses was lower than the satisfaction with the previous year's customers; only 75 percent answered either very or mostly satisfied when asked "How satisfied are you with your most recent postal experience?" Dissatisfaction increased for large business customers this year. Relative to last year, all but the Standard Mail and Library Mail categories decreased in satisfaction as evidenced by Table V-25.

Table V-25
CEM Results for Large Business Customers

Mail Products and Services	FY 2011	FY 2012	FY 2013
First-Class Mail	92.1	91.2	91
Single-Piece International	89.2	87.4	87.8
Standard Mail	85.6	85.7	85.6
Periodicals	84.3	84.9	83.3
Single-Piece Parcel Post	87.5	87.1	86.1
Media Mail	86.7	85.9	85.9
Bound Printed Matter	84.1	83.5	82.1
Library Mail	86.8	87	87.7

Source: Library Reference USPS-FY13-38; Library Reference USPS-FY12-29; FY 2011 ACD at 90.

[49] Large businesses had 100 to more than 1,000 employees.

APPENDIX A

EMPIRICAL REVIEW OF PRICE CAP APPLICATION

When the Postal Service adjusts market dominant prices, the Commission reviews the proposed set of rates for consistency with title 39 of the United States Code. The Commission's rules for modern rate regulation require the use of a backward-weighted volume index (a Laspeyres index) for the pre-implementation review of proposed rate adjustments for consistency with 39 U.S.C. 3622(d), the statutory price cap. This index is used to calculate the percentage change in rates for each class by using the most recently available historical billing determinants to weight the percentage change of each rate 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 rate cells. *See* 39 CFR 3010.23(d). 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 has included reviews of price adjustments in past ACDs. These "Appendix A" reviews consist of a comparison of the percentage change in rates 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 rates 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. R2012-3 rate adjustments, the CPI cap was applied to the market basket of services purchased in FY 2012.[2] If mailers purchased the exact same services in the full year that the new prices were in effect, then the new rates would produce the projected increases, consistent with the price cap. However, factors including the rate changes may affect the quantity and mix of purchased services. Thus, the market basket may change as a result of the new rates and other factors. In the past, the Appendix A analysis has used billing determinants that represent the market basket of purchased services at the new rates.

[1] *See* Docket No. RM2007-1, Order No. 26, Order Proposing Regulations to Establish a System of Ratemaking, August 15, 2007, at 33-36.37. *See* Docket No. RM2008-1, Order No. 194, Second Notice of Proposed Rulemaking to Establish a Procedure for According Appropriate Confidentiality, March 20, 2009.

[2] The billing determinants used in Docket No. R2012-3 were from a hybrid year consisting of FY 2011 Q4 – FY 2012 Q3.

This year, the Commission is unable to perform a complete post-implementation review of the Docket No. R2012-3 rate adjustments. Unlike the previous rate adjustments, the Docket No. R2012-3 adjustments included major classification changes. For instance, for First-Class Mail, the Postal Service changed the ounce increment for Presort Letters and Postcards from 1 ounce to 2 ounces. In order to estimate the impact of this combined rate and classification change, information on the volume of pieces containing between 1 and 2 ounces is necessary. This information is not currently available.[3] Because of all the classification changes in Docket No. R2013-3, there are insufficient data to allow the Commission to conduct an accurate empirical review of the Docket No. R2012-3 market dominant rate adjustments at this time.

[3] *See* Responses of the United States Postal Service to Questions 1-5 of Chairman's Information Request No. 7, February 24, 2014, question 3.

APPENDIX B

SPECIAL STUDY OF DELIVERY PERFORMANCE IN REMOTE LOCATIONS

Every two years, the Commission assesses a special study of final delivery service performance to the remote locations of the Alaska, Honolulu, and Caribbean Districts.[1] Each offshore district has several processing facilities which serve the more rural areas.[2] Service performance measuring the frequency of mail delivered and received within a product's service standard is not weighted for all classes of mail.[3] In FY 2013, there were more districts providing service performance results than the previous study in FY 2011. In some cases, these results met or exceeded Gateway service performance but for many products they did not.

In FY 2012 and FY 2013, the Postal Service made various modifications to Standard Mail, Periodicals Mail, and Package Services service standards designating to or originating from these non-contiguous locations "to more accurately reflect the service that the [Postal Service's] network is presently capable of providing for mail outside the contiguous forty-eight states."[4] Specifically, the modifications more appropriately align the service standards with the use of modes of transportation that may not be available every day (*e.g.*, certain boat and air-taxi services used by the Postal Service operate only on certain days of the week.)[5]

For Standard Mail, the maximum number of days to deliver increased from 10 to 14 days for destination entry mail, and from 22 to 27 days for End-to-End mail.[6] For Periodicals Mail, the maximum number of days to deliver increased from 7 to 11 days for destination entry mail, and from 20 to 26 days for End-to-End. For Package Services, the maximum number of days to deliver destination entry mail increased from 8 to 12, and the maximum number of days to deliver End-to-End mail increased from 20 to 26.[7] In these cases, comparisons to FY 2011 service performance results are reported with added consideration.

[1] Library Reference USPS-FY13-29, Offshore Special Study Results at 1.

[2] Alaska has six different primary postal facilities. Caribbean has two postal facilities for all postal processing. Honolulu has three primary postal facilities to process their designating mail. *See* Library Reference USPS-FY13-29, Offshore Special Study Results at 3.

[3] Library Reference USPS-FY13-29,Offshore Special Study Results at 3.

[4] 77 FR 31195 (May 25, 2012).

[5] Library Reference USPS-FY13-29, Offshore Special Study Results at 4.

[6] The Postal Service stated that changes made to Standard Mail service standards in non-contiguous regions of the United States are unrelated to its network rationalization. They are made to more accurately represent the service that is actually being provided for mail subject to surface transportation. Docket No. N2012-1, Advisory Opinion on Mail Processing Network Rationalization Service Changes, September 28, 2012, at 51. (Docket No. N2012-1 Advisory Opinion).

[7] *See* Docket No. N2012-1Advisory Opinion Docket at 49-54.

Single-Piece First-Class Mail Letters/Postcards/Flats

In FY 2013, most Single-Piece First-Class Mail Letters/Postcards/Flats service performance results were above 90 percent on-time. Table B-1 shows that most rural areas in Alaska do not have an overnight service standard and Honolulu and its rural areas, including Guam and the Samoa Islands, had relatively low 2-day and 3-5-day service performance results.

Table B-1
Single-Piece First-Class Mail Letters/Postcards/Flats

	Overnight		2-Day		3-5-day	
	FY11	**FY13**	**FY11**	**FY13**	**FY11**	**FY13**
Alaska	96.3	97.4	97.1	96.2	91.4	89.9
995 Gateway	***96.3***	***97.4***	***99.3***	***99.4***	***90.5***	***87.6***
995 Rural	NSS	NSS	97.9	97.8	93.7	95
996	NSS	NSS	98.1	98	95.3	94.5
997	NSS	NSS	92.9	93.4	92.9	93.4
998	NSS	NSS	96.5	90.3	87.6	82.8
999	NSS	NSS	98.5	95.4	89.1	85
Caribbean	93.8	94.5	96.3	98.8	85.7	83.4
009 Gateway	***94.4***	***95.1***	***97.2***	***98.6***	***85.6***	***82.6***
6	93.7	93.7	96.4	98.2	84.5	83.1
7	93.6	94.3	94.7	98.5	85.7	82.6
8	87.7	92.4	96	98.8	91.8	94.3
Honolulu	97.5	97.3	NSS	12.4	91.9	89.8
968 Gateway	***97.7***	***97.2***	***NSS***	***12.4***	***86.3***	***86.5***
96700-96798 Hawaiian Islands	97.5	97.4	NSS	NSS	96	95.6
96799 American Samoa	-	NSS	-	12.4	-	18.7
969 Guam	91.5	95.5	NSS	NSS	82.8	56.4
NSS = No Service Standard						

Source: Offshore Special Study FY2013 at 8.

Alaska

There is no overnight service standard for rural ZIP Codes in Alaska; however, service performance results for overnight service at the Gateway increased compared to FY 2011. Results for mail delivered with a 3-5-day service standard were relatively lower in the rural ZIP Code areas of 998 and 999. The Postal Service explains that these two areas are extremely isolated from the Gateway where most of the 3-day mail originating from other Alaska ZIP Code areas is processed.[8]

Caribbean

Service performance for most mail with a 3-5-day service standard slightly decreased as compared to FY 2011 except rural ZIP Code area 008. Performance results for mail with an overnight or 2-day service standard remained steady when compared to FY 2011 results. Overnight service performance results from the Gateway remained better than rural performance with the same standard.

[8] Offshore Special Study Results at 9.

Honolulu

Honolulu service standards are different from most contiguous United States standards. For example, American Samoa does not have an overnight standard, but has a 2-day standard to/from itself and is the only 2-day service standard within the Honolulu district. When comparing service performance from the rural areas to the 968 Gateway, American Samoa and Guam significantly underperformed in the 3-5-day service standard. The Postal Service explained that American Samoa's low score is likely due to limited air service to the island.[9]

Presort First-Class Mail Letters/Cards

The Postal Service measured service performance results using documented arrival times to start the clock and IMb scans by external reporters to stop the clock.[10] Table B-2 shows that in most instances only 3-5-day service performance results were available.

Table B-2
Presorted First-Class Mail Letters/Postcards

	Overnight		2-Day		3-5-day	
	FY11	**FY13**	**FY11**	**FY13**	**FY11**	**FY13**
Alaska	96.6	97.9	98.0	97.7	93.5	93.0
995 Gateway	**96.6**	**97.9**	**No Data**	**No Data**	**92.9**	**92.4**
995 Rural	NSS	NSS	98.0	97.9	96.0	96.7
996	NSS	NSS	98.0	97.7	95.9	96.5
997	NSS	NSS	No Data	95.2	94.4	95.2
998	NSS	NSS	No Data	No Data	89.5	82.1
999	NSS	NSS	No Data	No Data	87.7	79.7
Caribbean	No Data	No Data	No Data	No Data	85.3	90.2
009 Gateway	**No Data**	**No Data**	**No Data**	**No Data**	**85.7**	**90.2**
6	No Data	No Data	No Data	No Data	83.7	89.4
7	No Data	No Data	No Data	No Data	84.2	89.7
8	No Data	No Data	No Data	No Data	92.1	96.7
Honolulu	96.3	99.3	NSS	No Data	93.9	94.4
968 Gateway	**97.0**	**99.2**	**NSS**	**NSS**	**90.5**	**93.5**
96700-96798 Hawaiian Islands	95.9	99.3	NSS	NSS	95.9	97.9
96799 American Samoa	-	NSS	-	No Data	-	45.8
969	No Data	No Data	NSS	NSS	89.3	69.3
NSS = No Service Standard						
No Data = No data for this service standard.						

Source: Offshore Special Study Results at 11.

[9] *Id.* at 10. It is a 4-day service standard from the continental U.S. to ZIP Code Areas 967 as well as from 967 or 968 to American Samoa.
[10] *Id.* at 11.

Alaska

For overnight and 2-day service standards, there was either no service standard or no data available to compare to Gateway results. Three out of five rural districts performed better than the Gateway with a 3-5-day service standard. ZIP Codes 998 and 999 were again the lowest performers in Alaska. In addition, their results decreased as compared to FY 2011. The Postal Service explains, "Anchorage is the AADC for all parts of Alaska except ZIP Code Areas 998 and 999, where Seattle serves as the AADC. It is approximately 1,100 miles from Seattle to Ketchikan and another 288 from Ketchikan to Juneau which is significantly further away than the Anchorage AADC is to the rest of Alaska."[11]

Caribbean

Similar to Alaska regions, there was no data provided for the overnight and 2-day service standards. Results for the 3-5-day service standard category; however, increased as compared to FY 2011. In addition, service performance results from rural districts were either similar to or exceeded results when compared to the Gateway.

Honolulu

Service performance results reach nearly 100 percent on-time delivery in Honolulu and its rural districts. Three-to-five-day results were also relatively high when compared to the Gateway and other rural districts such as American Samoa.

Standard Mail

Table B-3 shows service performance results for destination entry and End-to-End Standard Mail Letters and Flats. Service performance results were notably lower when compared to First-Class Mail and Periodicals despite FY 2013 Gateway results far exceeding those from FY 2011. The differences in results compared to FY 2011 are, in part, due to the change in service standards implemented by the Postal Service.

[11] Library Reference USPS-FY13-29, Offshore Special Study Results at 12.

Table B-3
Standard Mail Letters and Flats

	Letters				Flats			
	Dest Entry	Dest Entry	E2E	E2E	Dest Entry	Dest Entry	E2E	E2E
	FY 2011	**FY 2013**	**FY 2011**	**FY 2013**	**FY 2011**	**FY 2013**	**FY 2011**	**FY 2013**
Alaska	72.3	95.4	30.8	83.4	42.0	93.0	21.7	77.2
995 Gateway	**80.3**	**97.8**	**31.5**	**84.7**	**46.1**	**92.8**	**27.8**	**76.3**
995 Rural	75.3	97.7	31.6	86.5	36.8	92.9	18.0	77.0
996	66.8	96.9	28.1	84.2	41.4	92.1	14.0	77.1
997	65.0	96.8	36.4	87.0	32.6	93.1	21.9	79.9
998	42.4	80.5	22.1	71.3	N/A	96.3	N/A	79.7
999	54.3	76.1	31.7	62.2	N/A	94.7	N/A	75.0
Caribbean	68.6	89.4	34	71.7	56.8	81.2	29.4	63.9
009 Gateway	**59.9**	**89.1**	**34.1**	**71.6**	**54.9**	**80.8**	**32.4**	**62.4**
006	78.4	91.5	31.7	72.9	57.2	81.4	24.5	67.1
007	70.3	88.6	34.7	71.2	57.9	84.6	30.0	69.0
008	57.9	87.5	42.7	69.6	59.4	76.0	29.0	55.9
Honolulu	14.7	67.1	6.2	34.5	4	50.3	1.5	36.5
968 Gateway	**14.2**	**67.4**	**7.4**	**33.1**	**7.1**	**58.3**	**2.6**	**40.4**
96700-96798 Hawaiian Islands	15.1	67.5	5.7	35.3	2.7	49.1	1.0	35.0
96799 American Samoa	-	25.1	-	14.0	-	11.7	-	8.0
969	0.3	24.9	4.8	21.9	1.2	19.4	1.2	25.6

Alaska

Similar to other classes of mail, service performance in rural Districts 998 and 999 was lower than performance in the Gateway for Standard Mail Letters. Scores for Flats, on the other hand, were significantly higher than the Gateway. A significant impact from service standard changes occurred in service performance results for District 998. Scores increased 38.1 percentage points for destination entry letters and 49.2 percentage points for End-to-End Letters delivery.

The entire Alaskan area saw considerable improvement in service performance results for Flats mail. The largest increase realized by the 996 district in End-to-End service performance underscores the significant change in results from FY 2011. The higher results in service performance measurement for destination entry letters are likely linked to increases in the maximum number of days to delivery from 10 to 14 days. Similarly, increases in End-to-End Letters are associated with increases in the maximum number of days to delivery from 22 to 27 days.

Caribbean

In FY 2013, service performance results from rural districts were comparable to the Gateway for destination entry and End-to-End Letters except District 008, which underperformed other districts and the Gateway with 60 percent on-time delivery for End-to-End Flats. As compared to FY 2011, however, they were significantly higher. Gateway results for destination entry and End-to-End Letters climbed 49 and 109 percent, respectively. Similar to the Alaskan region, the improvement in service performance scores are likely due to the change in service standards implemented by the Postal Service.

Honolulu

Service performance results for American Samoa and District 969 were well below Gateway results for all categories of Standard Mail Letters and Flats despite the changes in service standard.[12] Service performance remains poor when compared to the other non-contiguous regions.

Periodicals

In FY 2013, service performance results were divided into destination entry and End-to-End delivery performance and reflect increases in delivery service standards. Table B-4 shows that for most districts, rural and Gateway, destination entry results outperformed End-to-End service performance levels. The table also highlights the significant change in performance results after the Postal Service implemented its service standard changes to more accurately reflect network capabilities.[13]

Table B-4
Periodicals

	FY 11	Destination Entry FY 13	End-to-End FY 13
Alaska	63.1	87.4	80.1
995 Gateway	**68.7**	**89.7**	**82.1**
995 Rural	57.2	92.0	81.0
996	71.4	90.0	80.6
997	63.7	87.1	74.9
998	56.7	84.5	84.9
999	48.2	73.9	78.4
Caribbean	35.9	70.2	66.0
009 Gateway	**41.8**	**66.9**	**65.0**
006	34.1	70.0	67.6
007	43.7	72.3	71.4
008	16.7	76.2	57.5
Honolulu	70.7	63.4	38.5
968 Gateway	**73.8**	**61**	**40.1**
96700-96798 Hawaiian Islands	63.0	66.1	39.2
96799 American Samoa	-	4.4	9.6
969	80.4	16.5	24.2

[12] For destination entry mail, all of the Honolulu ZIP Code Areas have a 3-day service standard from the DSCF, excluding American Samoa. It is a 13-day Service Standard from the DNDC, with the exception of American Samoa, where it is 14 days. *Id.* at 15.

[13] 77 FR 31190 (May 25, 2012).

Alaska

In FY 2013, rural area 995 had an overnight service standard, whereas the rest of the districts have a 3-day service standard from the DSCF.[14] Similar to FY 2011 the lowest service performance results were in rural District 999.

Caribbean

In FY 2013, overnight service standards are applied to Districts 006, 007, and 008 for mail entered into the DSCF and destination area distribution center (DADC) in San Juan.[15] Rural District 008 has a 4-day service standard only for mail entered at the DADC. Service performance results for most districts outperformed the Gateway in destination entry and End-to-End mail.

Honolulu

Service performance results for American Samoa and rural District 969 were below the Gateway for both destination entry and End-to-End mail. There is an overnight service standard from the DSCF to Districts 967, 968, and 969 but not to American Samoa.[16] For End-to-End processing, Districts 969 and American Samoa receive an additional day for processing and transportation compared to the other districts.[17]

Package Services

Package Services measurement is based on retail Single-Piece Parcel Post through January 26, 2013, as well as Library Mail/Media Mail, and Bound Printed Matter Flats and Parcels.[18] Table B-5 illustrates that the rural Districts of 008, the Hawaiian Islands, America Samoa and District 969 had much lower performance results compared to their gateway and region despite changes in service standards.

[14] *Id.* at 16.

[15] *Id.* at 17.

[16] *Id.*

[17] *Id.*

[18] *Id.* at 18.

Table B-5
Package Services

	FY 2011	FY 2013
Alaska	25.5	77.9
995 Gateway	**31.3**	**89.5**
995 Rural	21.9	70.3
996	25.9	77.0
997	21.5	71.7
998	21.2	72.0
999	21.7	59.9
Caribbean	21.0	50.6
009 Gateway	**19.8**	**53.6**
006	23.9	51.5
007	24.4	53.2
008	7.7	28.5
Honolulu	6.40	33.7
968 Gateway	**6.9**	**45.9**
96700-96798 Hawaiian Islands	6.0	29.2
96799 American Samoa	-	9.7
969	8.0	17.1

Source: Offshore Special Study Results at 25-26.

Alaska

For End-to-End mail, all rural districts receive the same service standard. District 999 is approximately 30 percentage points lower than the Gateway and other districts. It also remained below the Gateway's service performance.

Caribbean

A 2-day service standard from the DSCF applies to Districts 006, 007, and 009 but not to 008, which receives a 3-day standard. Service performance results from District 008 continued to rank lowest relative to the other districts and the Gateway.

Honolulu

Districts 967, 968, and 969 receive a 2-day service standard for Package Services mail sent from the DSCF; this does not apply to American Samoa.[19] In FY 2013, service performance results far exceeded those from FY 2011; however, the scores are considerably lower than their non-contiguous counterparts. Persistently low results from the Gateway were even worse within rural districts despite changes in service standards.

[19] *Id.* at 20.

APPENDIX C

COMMISSION DIRECTED UNDERTAKINGS THAT MAY RESULT IN FUTURE ANALYTICAL PRINCIPLE CHANGES

STATUS LIST OF COMMISSION DIRECTED UNDERTAKINGS THAT MAY RESULT IN FUTURE ANALYTICAL PRINCIPLE CHANGES (FY 2012 ACD)

Service Measurement Proxy for Inbound Surface Parcel Post (at UPU rates)

- *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. FY 2012 ACD at 61.*
  - In the FY 2012 ACD, the Commission instructed the Postal Service to "propose use of an appropriate measurement system or proxy for Inbound Surface Parcel Post (at UPU rates) for service performance measurement in FY 2013." *Id*. The Postal Service continues to use Single-Piece Parcel Post as the proxy to measure service performance for Inbound Surface Parcel Post (at UPU rates). Response to CHIR No. 6, question 9.

Price Elasticity of Standard Mail Flats

- *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. FY 2012 ACD at 116.*
  - On January 27, 2014, Chairman's Information Request No. 4 was issued to the Postal Service to clarify the basis of the Postal Service's estimates in its FY 2013 ACR.[1] On February 6, 2014, the Postal Service filed its responses to CHIR No. 4 that included its response to the above Commission recommendation pertaining to elasticity estimates for Standard Mail Flats.[2] In its response to question 13, the Postal Service indicates that it re-estimates both aggregate and disaggregated shape-based (letters and non-letters) Standard Mail equations with new volume data that becomes available each quarter. However, "[t]o date, the disaggregated shaped-based equations have still not yielded results which would suggest that substituting the disaggregated elasticity estimates for the aggregate estimates would generate better forecasts or otherwise improve the assessment of the impact of price changes on contribution." *Id*. question 3.

[1] Chairman's Information Request No. 4, January 27, 2014 (CHIR No. 4).

[2] Reponses of the United States Postal Service to Questions 1-20 of Chairman's Information Request No. 4, February 6, 2014.

Negative Passthrough for Standard Automation Mixed AADC Letters

- *Regarding the negative passthrough for Standard Automation Mixed AADC letters, the Postal Service should re-examine the anomaly to better understand the costs associated with these workshare categories. FY 2012 ACD at 123.*
    - In its FY 2013 ACR, the Postal Service indicates that "[i]t appears that the main factors that served to reduce the 'OUT BCS SECONDARY' productivity in FY2012 were temporary. *See* Docket No. ACR2012, responses to CHIR No. 4, questions 18(a), 22, and 23. Thus, in FY2013 that productivity has increased to a level more in line with longer-term trends, which reduces the cost of sorting Automation Mixed AADC pieces." FY 2013 ACR at 22 n.15.

Cost Attribution for Products Handled by the Services Center

- *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. FY 2012 ACD at 143.*
    - On November 8, 2013, the Postal Service filed a petition pursuant to 39 CFR 3050.11 requesting the Commission initiate an informal rulemaking proceeding to consider three changes to analytical principles for use in periodic reporting.[3] Subsequently, on November 12, 2013, the Postal Service filed an errata, revising its Docket No. RM2014-1 Petition to add Proposal Nine.[4] The Postal Service indicates that Proposal Six will address the concerns raised by the Commission in the FY 2012 ACD. It proposes to update its methodology for calculating the costs for Philatelic Sales and handling costs of Stamp Fulfillment Services (SFS) in order to align the product description in the MCS. The Commission is reviewing these materials in Docket No. RM2014-1.

International Business Reply Mail Service Costs

- 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. FY 2012 ACD at 147.
    - On June 26, 2013, the Postal Service filed responses to various issues that were requested by the Commission in its FY 2012 ACD.[5] In its response, the Postal Service indicates that "[g]iven the small size of International Business Reply Mail Services…, and the resources that would be

[3] Docket No. RM2014-1, Petition of the United States Postal Service for the Initiation of a Proceeding to Consider Proposed Changes in Analytical Principles (Proposals Six Through Eight), November 8, 2013 (Docket No. RM2014-1 Petition).

[4] Notice of the United States Postal Service of Revision to Add Proposal Nine to the Petition for Rulemaking – Errata, November 12, 2013 (Revised Docket No. RM2014-1 Petition).

[5] Docket No. ACR2012, Reponses of the United States Postal Service to Commission Requests for Additional Information in FY 2012 Annual Compliance Determination, June 26, 2013 (Responses to FY 2012 ACD).

needed to calculate costs, the Postal Service submits that reporting the costs separately is not feasible." *Id*. question 1.

Package Intercept Service Costs

- *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. FY 2012 ACD at 163.*
  - The Postal Service proposed and the Commission accepted a methodology for estimating Package Intercept's revenues, attributable costs, and volumes until the Postal Service's technology allows the development of a more refined cost model.[6]

Competitive Post Office Box Service Costs

- 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. FY 2012 ACD at 163.
  - On November 8, 2013, the Postal Service filed a petition pursuant to 39 CFR 3050.11 requesting the Commission initiate an informal rulemaking proceeding to consider three changes to analytical principles for use in periodic reporting.[7] Subsequently, on November 12, 2013, the Postal Service filed an errata, revising its Docket No. RM2014-1 Petition to add Proposal Nine.[8] The Postal Service indicates that Proposal Seven will address the concerns raised by the Commission in the FY 2012 ACD. It proposes to update and improve the methodology for developing attributable costs for the enhancements to the competitive Post Office Box service. The Commission is reviewing these materials in Docket No. RM2014-1.

International Money Transfer Service Costs

- *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 11. 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. FY 2012 ACD at 166.*
  - On June 26, 2013, the Postal Service filed responses to various issues that were requested by the Commission in its FY 2012 ACD.[9] In its response, the Postal Service indicates that "[it]…

[6] *See* Docket No. CP2014-5, Order No. 1903, Order Approving Changes in Rates of General Applicability for Competitive Products, December 12, 2013, at 14-15.

[7] Docket No. RM2014-1 Petition.

[8] Revised Docket No. RM2014-1 Petition.

attempted to separate Outbound and Inbound IMTS in the FY 2011 and FY 2012 Annual Compliance Reports. The attempt provided relatively volatile and problematic results. In conclusion, given the small number of transactions and revenue, the separation proposed in Proposal Eleven should not be implemented going forward. The Postal Service recommends combining Inbound and Outbound IMTS revenue, volume, and costs to produce more statistically valid numbers." *Id*. question 2.

Global Plus and China Post Group NSA Costs

- *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. FY 2012 ACD at 169-72.*
  - On August 16, 2013, the Postal Service filed a petition pursuant to 39 CFR 3050.11 requesting that the Commission initiate an informal rulemaking proceeding to consider four proposals to change the analytical methods approved for use in periodic reporting.[10] In its Docket No. RM2013-6 Petition, the Postal Service also sought clarification concerning the status of a proposal previously filed by the Postal Service as part of its June 26, 2013 response to a Commission request for additional information arising from the FY 2012 ACD.[11]
  - On August 20, 2013, the Commission issued Order No. 1814 initiating a rulemaking proceeding that treated the Postal Service's request for clarification as a petition pursuant to 39 CFR 3050.11, and treating the Revised Response to FY 2012 ACD, question 3 as Proposal Five to be reviewed in Docket No. RM2013-6.[12] Proposal Five changes the current methodology based upon pounds for distributing settlement costs reported in the ICRA for Global Direct Outbound Admail to NSAs in the Global Plus products. The new methodology is based upon revenues.[13]
  - On February 4, 2014, the Commission issued Order No. 1983 approving Proposals One through Five.[14]

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[9] Responses to FY 2012 ACD.

[10] Docket No. RM2013-6, Petition of the United States Postal Service for the Initiation of a Proceeding to Consider Proposed Changes in Analytical Principles (Proposals One through Four), August 16, 2013 (Docket No. RM2013-6 Petition).

[11] *Id*. at 1; *see* Responses to FY 2012 ACD and Docket No. ACR2012, Revised Responses of the United States Postal Service to Commission Requests for Additional Information in FY 2012 Annual Compliance Determination, July 31, 2013 (Revised Responses to FY 2012 ACD).

[12] *See* Docket No. RM2013-6, Order No. 1814, Notice of Proposed Rulemaking on Analytical Principles Used in Periodic Reporting (Proposals One through Five), August 20, 2013.

[13] Proposal Five is described in the Postal Service's Revised Response to FY 2012 ACD, question 3.

[14] *See* Docket No. RM2013-6, Order No. 1983, Order on Analytical Principles Used in Periodic Reporting (Proposals One through Five), February 4, 2014.

Inbound Air Parcel Post and EPG Bilateral Agreements Plans

- 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. FY 2012 ACD at 172.
  - On June 26, 2013, the Postal Service filed responses to various issues that were requested by the Commission in its FY 2012 ACD.[15] In its response, the Postal Service indicates that "[it]… is working to improve the overall performance of inbound air parcels under EPG agreements. The strategy for EPG is to renegotiate rates with our largest partners where there is a net benefit to the Postal Service, considering both inbound and outbound flows." *Id.* question 4. In addition, the Postal Service states that "a performance action plan…[has been implemented]… to address operational issues for EPG Parcels. The operational improvements will decrease penalty payments and result in increased revenue." *Id.* Under the EPG arrangement, the Postal Service "does not believe it is in its best interest to cease its participation…, as this would have a negative effect on the Postal Service's financial position." *Id.*

LIST OF COMMISSION DIRECTED UNDERTAKINGS THAT MAY RESULT IN FUTURE ANALYTICAL PRINCIPLE CHANGES (FY 2013 ACD)

Excess Passthroughs Resulting from Timing of Price Adjustments

- *Because the timing of price adjustments is not a statutory exemption for passthroughs over 100 percent, the Postal Service should consider different approaches for setting workshare discounts, including projecting cost avoidances, that may reduce the number of discounts with passthroughs above 100 percent resulting from the timing of price adjustments. Alternatively, the Postal Service should consider revising the schedule of market dominant price adjustments. FY 2013 ACD at 14-15.*

Investigation of Certain Additional Costs

- *The Commission encourages the Postal Service to investigate the additional costs it has listed, such as allied operations, manual processing, and transportation costs, to ensure the avoided costs model accurately reflects the additional cost savings for having more finely presorted mail. FY 2013 ACD at 25.*

Further Derivation of Elasticity for Standard Mail Products

- *The Commission appreciates the Postal Service's efforts to derive elasticity estimates as recommended in the FY 2012 ACD. Having these elasticity estimates would provide for a more realistic assessment of the impact of price changes on volume and total contribution. Therefore, the Postal Service should continue its efforts to derive elasticity estimates for Standard Mail products. FY 2013 ACD at 55.*

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[15] Responses to FY 2012 ACD.

Costing Methodology for Parcel Return Service Full Network Contracts

- *The Commission directs the Postal Service to develop a revised costing methodology that can be used for this contract and future Parcel Return Service Full Network contracts. The Postal Service should file the proposed methodology in a rulemaking proceeding within 90 days of the issuance of the FY 2013 ACD. If Parcel Return Service Contract 4 does not cover costs under the revised costing methodology, within 90 days of the Commission's decision on the proposed methodology, the Postal Service will have to revise the terms of, or terminate, the contract. FY 2013 ACD at 82-83.*

Costing of IPA Product

- *The Commission therefore directs that the Postal Service report within 90 days and reconfirm that the IPA product will cover the projected attributable costs in FY 2014. The Postal Service shall also provide an analysis of the causes of the FY 2013 loss and decrease in cost coverage. In addition, the Postal Service is to recommend modifications to its current methodology of developing costs and, if necessary, propose the modifications in a rulemaking, so as to improve the reliability of such costs for the IPA product. FY 2013 ACD at 86.*

Performance Measure for Inbound Surface Parcel Post/Alaska Bypass Service

- *Within 90 days of the issuance of this ACD, the Postal Service shall propose to the Commission appropriate measurement systems for both Inbound Surface Parcel Post (at UPU rates) and Alaska Bypass Service. FY 2013 ACD at 115.*

APPENDIX D

COMMENTERS
2013 ANNUAL COMPLIANCE DETERMINATION

Commenter	Comment Citation	Citation Short Form
American Catalog Mailers Association	Initial Comments of the American Catalog Mailers Association (ACMA)	ACMA Comments
	January 31, 2014	
American Catalog Mailers Association	Reply Comments of the American Catalog Mailers Association (ACMA)	ACMA Reply Comments
	February 14, 2014	
Association for Postal Commerce	Reply Comments of the Association for Postal Commerce	PostCom Reply Comments
	February 14, 2014	
Greeting Card Association	Initial Comments of the Greeting Card Association	GCA Comments
	January 31, 2014	
Magazine Publishers of America, Inc., and Alliance of Nonprofit Mailers	Reply Comments of Magazine Publishers of America, Inc., and Alliance of Nonprofit Mailers	MPA & ANM Reply Comments
	February 14, 2014	
Newspaper Association of America	Comments of the Newspaper Association of America	NAA Comments
	January 31, 2014	
Parcel Shippers Association	Reply Comments of the Parcel Shippers Association	PSA Reply Comments
	February 14, 2014	
Pitney Bowes Inc.	Comments of Pitney Bowes Inc.	Pitney Bowes Comments
	January 31, 2014	

Commenter	Comment Citation	Citation Short Form
Pitney Bowes Inc.	Reply Comments of Pitney Bowes Inc.	Pitney Bowes Reply Comments
	February 14, 2014	
Pitney Bowes Inc.	Supplemental Comments of Pitney Bowes Inc.	Pitney Bowes Supplemental Comments
	March 4, 2014	
Public Representative	Public Representative Comments	PR Comments
	January 31, 2014	
Public Representative	Public Representative Reply Comments	PR Reply Comments
	February 14, 2014	
Public Representative	Public Representative Notice of Errata to Public Representative Reply Comments	PR Reply Comments—Errata
	February 24, 2014	
United Parcel Service	Initial Comments of United Parcel Service on Postal Service's FY2013 Annual Compliance Report	UPS Initial Comments
	January 31, 2014	
United States Postal Service	Reply Comments of the United States Postal Service	Postal Service Reply Comments
	February 14, 2014	
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 2013 Annual Compliance Report	Valpak Comments
	January 31, 2014	
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 2013 Annual Compliance Report	Valpak Reply Comments
	February 18, 2014	

APPENDIX E

ABBREVIATIONS

Long Version	Abbreviation
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 2013 Annual Performance Plan	FY 2013 Plan
FY 2014 Annual Performance Plan	FY 2014 Plan
FY 2012 Annual Performance Report	FY 2012 Report
FY 2013 Annual Performance Report	FY 2013 Report
FY 2013 Annual Report to Congress	FY 2013 Annual Report to Congress
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
Community Post Office	CPO
FY 2010 Comprehensive Statement on Postal Operations	FY 2010 Comprehensive Statement
Consumer Price Index for all urban consumers	CPI-U
Contract Postal Unit	CPU
Cost and Revenue Analysis	CRA
Critical Entry Time	CET

Long Version	Abbreviation
Customer Experience Measurement	CEM
Customer Supplier Agreement	CSA
Deliveries per Work Hour	DPWH
Delivery Bar Code Sorter	DBCS
Delivery Point Sequence	DPS
Destination Sectional Center Facility	DSCF
Destination Area Distribution Center	DADC
Destination Delivery Unit	DDU
Destination Bulk Mail Center	DBMC
Destination Network Distribution Center	DNDC
Direct Marketing Association	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	GEPS—NPR
Global Reseller Expedited Package Services	GREPS
Gross Domestic Product	GDP
Integrated Financial Plan	IFP
Intelligent Mail Barcode	IMb
Intelligent Mail Accuracy and Performance System	iMAPS
International Business Reply Service	IBRS
International Cost and Revenue Analysis	ICRA
International Mail Measurement System	IMMS
International Money Transfer Service—Inbound	IMTS—Inbound
International Money Transfer Service—Outbound	IMTS—Outbound
International Priority Airmail	IPA

Long Version	Abbreviation
International Service Center	ISC
International Surface Air Lift	ISAL
In-Office Cost System	IOCS
Mail Classification Schedule	MCS
Mailer Identification	MID
Mixed Area Distribution Center	Mixed ADC
National Association of Presort Mailers	NAPM
Negotiated Service Agreement	NSA
Network Distribution Center	NDC
Not-Flat Machinable	NFM
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
Point of Service	POS
Post Office Box	PO Box
Postal Accountability and Enhancement Act	PAEA
Postal Qualified Wholesaler	PQW
Priority Mail International	PMI
Processing and Distribution Center/Facility	P&DC/F
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
Transportation Cost System	TRACS
Universal Postal Union	UPU
Upgraded Flats Sorting Machine	UFSM
Village Post Offices	VPO
Voice of the Employee	VOE

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In connection with Section 2 of the Plain Writing Act of 2010, the Postal Regulatory Commission is committed to providing communications that are valuable to our readers.

We would like to hear your comments on what you find useful about our Annual Compliance Determination report and how we can improve its readability and value.

Please contact the Commission's Office of Public Affairs and Government Relations to provide your feedback.

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